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Politics this week

Feb 17th 2005
From The Economist print edition

Death of a statesman

AP

Rafik Hariri, **Lebanon**'s former prime minister and the architect of its revival since the end of its civil war, was killed by a massive bomb in Beirut, which also killed 16 others. Many in Lebanon suspected Syria, whose troops still occupy Lebanon, of involvement. America recalled its ambassador from Syria for "consultations". Iran offered Syria unconditional support in a "united front" against their (unnamed) enemies.

See article

Iraq's provisional election results were announced. An alliance of Shia parties captured 48% of the vote, and looked likely to have its nominee, Ibrahim al-Jaafari, named prime minister. A Kurdish alliance won 26% and swept the northern provinces. The victors scrambled to bring more Sunni Arabs into government; most Sunnis had boycotted the poll, so their parties won hardly any votes.

See article

Under pressure from other African leaders, **Togo**'s government, which seized power after the death of the country's long-serving dictator, Gnassingbé Eyadéma, earlier this month, promised to hold elections within 60 days. The Togolese opposition called for Eyadéma's son, whom the army had installed as president, to resign.

On the streets, again

Tens of thousands of pupils and teachers, in Paris and other parts of **France**, took part in demonstrations against a proposed educational reform which parliament is debating. Critics said the proposal to increase the use of continuous assessment rather than examination would sharpen inequality and leave many students with useless qualifications.

Yulia Tymoshenko, the new prime minister of **Ukraine**, said as many as 3,000 firms that had been privatised by the previous administration might now be taken back into state hands. This went much further than a previous pledge by President Victor Yushchenko to target only 30 or 40 leading firms for possible renationalisation because of irregularities in their sale.

Kosovo has made "insufficient" progress towards meeting internationally agreed standards with regard to human rights, respect for minorities, and law and order, so it is premature to consider settling its long-term status, according to a report by UN secretary-general Kofi Annan.

A last-minute judicial appeal by supporters of **foxhunting** in Britain was rejected. After seven years of parliamentary debate, a ban finally came into force. Still at issue, however, is how strictly the ban will be policed.

The magic bus

India and Pakistan finally agreed to institute a bus service across the ceasefire line in **Kashmir**. The deal, which will reunite thousands of families, was announced at talks between the two countries' foreign ministers.

See article

Reuters

An explosion at a coal mine in Liaoning province, in the north-east of **China**, killed at least 210 miners, the worst reported mining disaster in the country for decades. An explosion at another (illegal) mine in the south-west of the country killed at least five.

More than 500 people were killed in **Pakistan** after torrential rain caused flooding and avalanches. Officials in Baluchistan said five villages were swept into the Arabian Sea when a dam burst near Pasni, 650km (400 miles) from the provincial capital, Quetta.

The much-trumpeted **Kyoto protocol** came into effect. The plan calls for 35 industrialised nations (plus the European Union) to cut their emissions of “greenhouse gases”, said to result in climate change. Developing powerhouses such as China and India are exempt. The United States, the world's largest emitter, has not ratified the protocol but says it is committed to reducing its emissions by 18% before 2012 and will spend $5.8 billion this year on research. The EU said it would take action against Britain if it did not stick to an agreed quota of carbon-dioxide emissions.

Murder in the rainforest

In Pará, a state in the Brazilian **Amazon**, thousands turned out for the funeral of Dorothy Stang, an American nun who had spent the past 20 years defending conservation and poor migrants. She was murdered by two gunmen.

See article

Brazil's president, Luiz Inácio Lula da Silva, suffered an unexpected political setback when his candidate to preside over the lower house of Congress was defeated by a conservative backbencher, albeit a nominal supporter of the government.

See article

Canada's minority Liberal government suffered an unexpected defeat in the House of Commons when the opposition voted down a bill to split the Department of Foreign Affairs and International Trade into two. Earlier, Paul Martin, the prime minister, told a judicial inquiry that he knew nothing about the mismanagement of a federal-government scheme to promote Canadian unity.

See article

Álvaro Uribe, **Colombia's** president, met his counterpart from **Venezuela**, Hugo Chávez, in an effort to defuse a row over a Colombian guerrilla leader who was abducted in Caracas and then arrested in Colombia. Mr Chávez agreed to end his suspension of bilateral trade agreements.

He's back

Reuters

In America, **Howard Dean** was elected as chairman of the Democratic National Committee. Mr Dean now faces the task of rallying the party in time for next year's congressional elections.

The Senate handed George Bush his first legislative victory in his new term by voting to curtail the scope of **class-action lawsuits**. But Mr Bush warned Congress that he will veto any tinkering to the new Medicare drug benefit.

See article

Porter Goss, the new director of the **CIA**, told the Senate it was only a matter of time before groups such as al-Qaeda tried to use weapons of mass destruction.

Gregory Mankiw, the chairman of Mr Bush's Council of Economic Advisers, said he was stepping down and returning to academia.

Arnold Schwarzenegger nominated Bruce McPherson, a moderate Republican, as California's next secretary of state (a post that includes responsibility for the state's election systems). Meanwhile, Mr Schwarzenegger called the state's Democrats “addicts” for not cutting back on spending.

The **National Hockey League** cancelled its season in a row with players over salary caps.

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Business this week

Feb 17th 2005
From The Economist print edition

GM walks away

General Motors agreed to pay **Fiat** *euro*1.55 billion ($2 billion) to cancel the “put” option that would have forced GM to buy the 90% of the Italian carmaker that it did not own, ending months of protracted negotiations and threats of lawsuits. Fiat shares rose slightly, but analysts predict the cash alone will not be enough to turn the troubled Italian carmaker around.

See article

Boeing unveiled its new 777-200LR. The plane has a range of 9,420 nautical miles (17,446km), farther than any other commercial passenger jet. The new 777 is at the heart of Boeing's strategy, which is betting on passengers' desire to fly directly between any two cities in the world. Last month, Airbus unveiled its A-380 plane that carries more people, but will mostly fly between airline hubs.

America's Food and Drug Administration said it would create a new independent board to monitor the **safety of pharmaceuticals**. Meanwhile, an advisory committee at the FDA held hearings on the safety of the COX-2 inhibitor class of pain-relieving drugs associated with nasty cardiovascular side-effects.

See article

Coca-Cola reported fourth-quarter net income of $1.2 billion, an increase of 30% over the same period a year earlier.

The death of distance

Verizon said it would buy **MCI** in a deal worth $6.7 billion, just two weeks after SBC Communications laid out its plans for acquiring AT&T. Both deals mark the end for American telecoms that function as stand-alone long-distance operators.

See article

Qwest (which saw its higher $7.3 billion cash and stocks bid for MCI rejected) posted a loss of $139m for the fourth quarter, compared with a loss of $407m for the same period in 2003. The company shed 12% of its workforce in 2004.

Nokia said it would work with Microsoft to enable the easier transfer of music from PCs to mobile phones. The world's largest mobile-phone maker will make new handsets that are compatible with Microsoft's media player.

A new reporting network was announced to clamp down on “phishing”, **identity-theft** scams that lure e-mail users into revealing their bank-account details. Meanwhile, Microsoft said it would build protections against spyware (software that is surreptitiously planted on PCs to track internet usage) into its Internet Explorer.

Insurance principles

California's department of insurance agreed to a $600m settlement of a civil lawsuit against Crédit Lyonnais over the French bank's acquisition of **Executive Life**, an insurance firm based in the state. The department alleged, among other things, that in 1991 Crédit Lyonnais, state-owned at the time, broke Californian law.

Three more insurance executives, one from Marsh & McLennan and two from American International Group, pleaded guilty in an **insurance-fraud** case brought by New York's attorney-general. This week's admissions brings the total number of insurance executives who have pleaded guilty to nine.

The European Union introduced much stiffer rules for **compensating airline passengers** inconvenienced by overbooking, cancellations and delays. Airlines protested and their trade body, the International Air Transport Association, said it would challenge the new rules in court.

Commerzbank posted a net profit of *euro*99m ($128m) for the fourth quarter. The German bank had posted a net loss of *euro*88m for the same period a year earlier.

America's second-largest electronics retailer, **Circuit City**, revealed it had received a $3.25 billion takeover bid from Highfields Capital Management, a Boston-based hedge fund that owns almost 7% of the company. Meanwhile, Circuit City said it was closing 19 of its superstores.

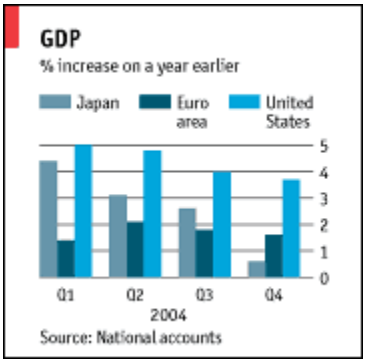
The **New York Mercantile Exchange** announced it would open an energy-futures exchange in London, in direct competition with the International Petroleum Exchange based there.

Construction of new American homes rose by 4.7% in January; the actual number of new units being built was at its highest level for 21 years.

The return of sclerosis?

Japan's GDP rose by 0.6% in the year to the fourth quarter. However, GDP fell by 0.5% (at an annual rate) compared with the previous quarter, the third successive quarterly contraction. A poor performance from **Germany** (GDP fell by 0.2% in the fourth quarter compared with the three previous months) affected growth in the euro area. GDP for the zone's 12 countries grew by only 1.6% for the year to the fourth quarter, much less than expected.

See article



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Mr Bush goes to Belgium

Feb 17th 2005
From The Economist print edition

The Atlantic alliance is in trouble. It is worth making some sacrifices to save it

LAST week Condoleezza Rice buttered the natives up nicely. Next week George Bush braves the wilds of Brussels at the start of a European tour of his own, in order, as his new secretary of state put it in Paris, “to continue our conversation”. How reassuring that the United States and Europe are conversing again, not shouting as they did before and after the war in Iraq. But how deep does this new warmth go? And if it is only skin-deep, how much does the continuing chill matter?

In the past several months, three big things have helped to warm the currents across the Atlantic. The foremost is that, against the hopes of most Europeans, American voters have given Mr Bush a second term. Whether they like him or not, and they still do not, France's Jacques Chirac, Germany's Gerhard Schröder and Russia's Vladimir Putin have no choice but to do business with the man who has just won four more years in the White House.

A second big help is that Mr Bush is not preparing to invade foreign countries right now. Though the Americans do not rule out future strikes against suspected nuclear proliferators such as Iran, or confirmed ones such as North Korea, the word from Washington is that military action is not yet on the agenda. For the time being, America endorses the efforts of Britain, France and Germany to use diplomacy to extract nuclear good behaviour from Iran. Europeans of a nervous disposition find it easier to shake Uncle Sam's hand when he is not using his other one to sharpen a bayonet.

He's back, wearing a halo

Last, on this visit to Europe Mr Bush has a better story to tell than he did last year. When Iraq's much-feared weapons of mass destruction failed to materialise, and after the American invasion produced both chaos and the torture scandal of Abu Ghraib, Mr Bush's claim to be acting in a noble cause rang hollow throughout the world (see article). Now much has changed. Iraqis showed in January's election that they take their new democracy seriously, even if politicians in France and Germany did not expect them to. In a speech in Munich last week, Donald Rumsfeld, America's defence secretary, hooped together the elections in Iraq, Afghanistan, Ukraine and the Palestinian territories—plus the Palestinian ceasefire with Israel—in a single narrative of peace and democracy on the march, helped on their way by a freedom-spreading America. Onlookers are entitled to question just how much credit America deserves for a few of these welcome developments, especially those in Palestine. But the cumulative effect of all of them is to have put substance on the claim Mr Bush made in his inauguration speech that he was pursuing America's “great liberating tradition” in foreign policy.

Mr Bush's freedom talk is associated in European minds with a readiness to reach for the gun in a world drawn too simply in cowboy blacks and whites. It raises obvious questions of consistency: why so hard on Syria and Iran (which have just formed a “common front” to resist America), so soft on Egypt, Saudi Arabia and Pakistan? But it behoves Europeans at least to give Mr Bush's ideas a hearing. This is not only because it was indeed America that liberated their own continent—one half in the second world war and the other in the cold war. It is also because Mr Bush's formula—“the survival of liberty in our land increasingly depends on the success of liberty in other lands”—is not so different from what Europeans claim they believe too: that the right answer to what happened on September 11th 2001 is not only to hunt down and kill the terrorists but also to pull up terrorism's “root causes”.

A simple and scary idea

One glaring difficulty is that reasonable people can disagree about what terrorism's causes are—or, if they do agree, on how the uprooting is to be done. In his second-term pronouncements so far, Mr Bush has given no sign of disavowing the neo-conservative view that the chief motor of terrorism is the incomplete spread of democracy in the world, and especially its absence among the Arabs of the Middle East. Some European policymakers agree with this diagnosis. Others find it too simple. Almost all find the idea of actually doing something about it audacious—perhaps even reckless.

That may be why Europeans prefer to say that the root cause of terrorism is poverty—or the unresolved conflict in Palestine, which they accuse Mr Bush of having dangerously neglected during his first term. The true answer is plainly a combination of these things. Israel—sometimes because of its post-1967 occupation of Palestinian territories, sometimes just because it exists—does inflame Muslim rage. But for a long time authoritarian Muslim regimes have also used the conflict as a pretext to postpone reform and democracy at home.

In principle, this difference of emphasis ought not to prevent the European Union and the United States from combining their efforts in the Middle East. Both are spending money on programmes to strengthen “civil society” and preach the virtues of freedom. Both are co-authors of the “road map” to peace. Both advocate an independent Palestine in the West Bank and Gaza after these have been evacuated by Israel. Europeans and Americans alike have welcomed the election of the moderate Mahmoud Abbas as Yasser Arafat's successor, and both are now helping to improve the efficiency of the Palestinian Authority and raise living standards in the occupied territories. On the face of it, there is little reason for Mr Bush and his European partners to fall out over Palestine.

And yet, when the time comes to negotiate a final peace, they probably will. Many Europeans, blaming mainly Israel for the impasse since 1967, would love to see America “deliver” the Israelis by forcing them right back to the pre-1967 border, even if this means uprooting all the settlements Israel has built in the occupied lands. Mr Bush, however, has already offended Arab and European sentiment by conceding last year that it is unrealistic to expect Israel to make a “full and complete” return, or accept the return of Palestinian refugees in numbers that would extinguish its vocation as Jewish state.

Do such differences boil down to tactics, or do they reflect a deeper split? It is more than tactics. European leaders, tending to see Israel's colonisation of the Palestinian territories as a version of their own colonial sins, are no longer as willing as they once were to give Israel the benefit of their post-Holocaust guilt. Americans are more apt to see Israel as a plucky democracy in a sea of dictatorships, compelled as America itself was after September 11th to use extreme force against the suicide terrorists and those who send them. This point of view is buttressed by powerful domestic constituencies, including Christian fundamentalists as well as American Jews. In such circumstances, no American president can be relied on to apply the brutal pressure on Israel which

some Europeans consider necessary—and Europe does the Palestinians no favours by misleading them to expect it.

Europeans may deplore the domestic interests in America that prevent it from taking the remedial action they think is called for in the Middle East. But, of course, Europe's own posture in the region is no less constrained by calculations of interest. Its fast-growing Muslim population detests Zionism. The Arab world, a long way from America, is the European Union's neighbour across the Mediterranean, and will be a land neighbour too if Turkey becomes an EU member. This makes it harder for European governments to empathise in public with Israel, and they are less casual than Mr Bush often sounds about shaking up the existing order in the Middle East in the name of an idea as abstract as spreading “freedom”.

Regime change, part two?

Naturally, European governments profess an attachment no less adamant than America's to democracy and its benefits. And in recent years they have done a great deal to enlarge democracy's domain by accepting as EU members those countries of central and eastern Europe that have shown themselves able to embrace the Union's norms. Mr Bush, however, seems to believe that a corollary of loving freedom is loathing tyranny—and that to promote democracy it is sometimes necessary for outsiders to remove dictatorial regimes. So although, to Europe's great relief, new American military action is not “on the agenda” at present, the invasion of Iraq has been followed by a rising tide of American threats against “outposts of tyranny” such as Syria and Iran. Here too, the differences across the Atlantic are partly tactical, but in part also a reflection of diverging interests—and ideas.

As in Palestine, America and Europe would seem to share the same broad aim in Iran. Both say that as a signatory of the Nuclear Non-Proliferation Treaty (NPT), the Islamic Republic should not be allowed to develop nuclear weapons. The Americans claim to support the efforts of Britain, France and Germany to make Iran stop enriching uranium and take other steps to prove that despite a well-documented history of deceiving international inspectors it is not building a bomb. This unity of purpose, however, masks a split. In private, the Americans do not expect the European effort to succeed. They are convinced that Iran does indeed crave nuclear weapons, and are impatient for the Europeans to admit failure, so that the issue can be moved to the Security Council for sanctions to be applied—with the possibility of military action later.

On one level, this looks like a quarrel about methods. American diplomats reckon it will take pressure or even force to deflect Iran from its nuclear trajectory. European diplomats assert that persuasion could work—if only America did its part by removing Iran's fear that America intends to clobber it. But the difference is weightier than this. One reason Mr Bush would find it hard to give Iran the security guarantees it wants is that the Iranian regime—a repressive theocracy, which calls for the destruction of Israel and supports the terrorists trying to undermine the ceasefire in Palestine—is the antithesis of everything America now says it wants for the region and beyond. In Washington a lively debate is now taking place over whether it might be simpler and more satisfactory to change the regime in Tehran than to curb its nuclear aims.

To some degree, these cross-Atlantic differences follow a pattern. Mr Bush is building his second-term foreign policy in a spirit at once more paranoid and more optimistic than Europe's. As the president on watch when al-Qaeda struck the twin towers, he continues to see the world as a more dangerous place than Europeans take it to be. Yet in spite of all the problems he has run into in Iraq, he retains his faith in the power of robust American deeds, and the export of American values, to make it safer. Europe's leaders seem by contrast both less anxious and more pessimistic. They are less anxious about terrorism (Europe has lived with it for generations) and about threats such as a nuclear Iran (undesirable, of course, but why can it not be contained like

other obnoxious nuclear powers by a system of deterrence?). They are less optimistic than Mr Bush claims to be about the healing power of democracy, especially its power to transform the Arab world.

All of this suggests applying a proper scepticism to the warm speeches Mr Bush will deliver and listen to on his progress through Europe next week. Though it suits Europe and America to put some of the awkwardness of Iraq behind them, there are bound to be collisions ahead—not only over what to do in Palestine and Iran, and whether to “force” democracy on the Arabs, but also over European arms sales to China, the standing of the world criminal court, the Kyoto climate treaty, reform of the Security Council and much else.

The alliance can be saved

These differences matter. The Iraq war accelerated the growing apart of a Europe free at last from the Soviet shadow and an America with work to do elsewhere. Terrorism is a common threat, but one too amorphous to provide the same sense of mutual dependence. There will, as Mr Schröder said last week, be no going back to the old European habit of deferring to the protective superpower. The Atlantic alliance could indeed die, if politicians neglect it.

But it does not have to. Increasingly—in the Balkans, Afghanistan, even Iraq—European members of NATO are picking up a share of America's burden. The values that hold America and Europe together are still stronger than the differences pulling them apart—and stronger still than whatever bonds Europe or America seem likely to form elsewhere. During the Iraq quarrel, France and Germany seemed at one point to be edging closer to Russia, the embryo of an alliance that was stillborn and looks entirely preposterous now that Mr Putin has retreated so far from western values. For the same reason, fears that Europe will attach itself to a rising China to balance the power of America belong to the distant future.

America and Europe no longer have precisely the same view of danger, or identical interests, or a similar appetite for risk. They will not always be able to act together in the outside world. But when they do, they can still command unparalleled military and moral power. Keeping open the possibility of joint action is something for which each side should be willing to make sacrifices. An alliance such as this needs to be nurtured, not left to wither unattended on the vine.

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Management education

School for scandal

Feb 17th 2005
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Is the MBA responsible for moral turpitude at the top?

SEVERAL of the corporate scandals that took place in the early years of this decade are currently being replayed in courtrooms from New York to Alabama. The trials of top executives at HealthSouth, Tyco International and WorldCom are reminding the public how unethical was the behaviour of some of the nation's top managers only a few short years ago.

The finger of blame for this behaviour is sometimes pointed at the MBA, the degree offered by business schools from Harvard to Hawaii. Perhaps this is not as odd as it sounds. After all, MBAs lay as thick on the ground at Enron as managerial hubris, and disinterested outsiders are not alone in asking whether there might have been some connection.

In an extraordinary *mea culpa*, Sumantra Ghoshal, a respected business academic who died last year, argued in a paper to be published shortly that the way MBA students are taught has freed them "from any sense of moral responsibility" for what they subsequently do in their business lives. This, he believed (and other respected academics, such as Jeffrey Pfeffer of Stanford, are carrying his argument forward), is because management studies have been hi-jacked intellectually by the dismal science of economics.

A stout defence of the virtues of economics from a publication called *The Economist* would hardly be a surprise. But, in fact, this is not necessary to refute the claim that business schools are responsible for moral turpitude at the top of corporate America. As it happens, most of the erstwhile corporate leaders currently appearing in the dock never went near one (see article), whereas many acknowledged champions of business ethics, such as Lou Gerstner at IBM, did.

What's more, many of the top business schools have taken steps to offset any ethically desensitising influence there may have been in their MBA coursework. They have greatly expanded their teaching of business ethics—some by introducing special courses, others in more memorable ways. Tuck School of Business, for example, persuades an ex-convict to come every year to tell its MBA students of his regrets.

The dubious claim that business schools are responsible for the moral failures of their graduates decades after graduation does, however, highlight one widespread misunderstanding about the role and purpose of an MBA.

Mr Ghoshal and his supporters are right that top business schools strive for academic respectability, and that this has led them to rely heavily on economic theory. But they are wrong

to criticise this. As long as schools are teaching academic degrees (and, after all, the letters MBA stand for Master of Business Administration), they have to teach the most compelling business theories around. It may be a pity that these are mostly to be found in economics. But that is the fault of other disciplines for not coming up with ideas to rival, for example, agency theory or the maximisation of shareholder value.

The real problem arises when students, or their new employers, believe that an MBA is, somehow, a qualification for business leadership. It is not, nor could any academic degree provide this. Law or medical degrees are necessary but not sufficient for the making of outstanding lawyers or doctors. In a similar way, a good MBA degree can help provide a student with analytical skills and theoretical knowledge useful to a business career. But becoming a successful leader of men and women in a turbulent business world requires maturity and wisdom. Happily, there is no degree programme for those.

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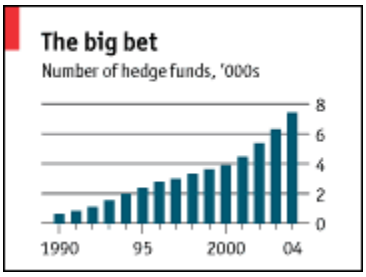
Hedge funds

A wise investment?

Feb 17th 2005
From The Economist print edition

Investors need to become much more sceptical about hedge funds



WHEN an opaque investment fund that does no hedging (in other words, it takes no positions designed to offset other bets) calls itself a hedge fund, charges the sky-high fees of a typical hedge fund and has wannabe customers banging on its door, it is time to ask: what is going on? The rise of hedge funds is not new. But the funds continue to grow strongly, attracting billions in new money and piquing the interest of investors who, until recently, would never have considered them. Among the new customers are some of America's biggest public pension funds, whose beneficiaries almost certainly have no idea that some of their savings are about to be poured into such murky investments.

As more and more hedge funds are created across a widening range of investment styles, so they are having an ever greater impact on the structure and efficiency of capital markets. With little outside scrutiny, hedge funds can move vast sums at speed as they seek out opportunities. That can be useful. Authoritative observers, including Alan Greenspan, chairman of the Federal Reserve, credit hedge funds with adding a layer of robustness to the financial system. It is true that hedge funds' willingness to take on risk means that they have been a helpful influence on some bankruptcy proceedings and emergency refinancings. They have also brought much-needed liquidity to neglected corners of financial markets. And their habit of selling against unwarranted price rises can act as a restraint on bouts of irrational exuberance.

But hedge funds can also be risky. The imminent collapse in 1998 of Long-Term Capital Management, a big hedge fund, compelled the New York Fed to step in (perhaps wrongly) with a rescue plan to stop a cascade of other failures. Since then, the hedge-fund industry has mushroomed and become more controversial. Are the high fees which hedge funds charge really justified by performance better than that offered by conventional funds? Can they really protect customers from losing money when markets are falling, as some claim? And, perhaps most pressing, is it right that hedge funds, once sold only to the very wealthy and financially aware, are increasingly being touted as safe for relatively unsophisticated investors?

The answers to these questions are respectively: no; mostly no; and a definite no (see article). Hedge funds have lately been receiving more attention from regulators, and rightly so. Beginning next year, America's Securities Exchange Commission (SEC) will require the management companies of all hedge funds with American customers to register their existence—although not yet details about the actual funds themselves. This newspaper was against the idea of registration when it was first mooted last year. Given how the industry has developed, however, this relatively light-touch form of regulation now seems appropriate. Knowing how many funds there are and who owns them is useful information that is currently impossible to obtain.

But should regulators go much further? Although there is a stronger case today than there was a year ago for more regulatory intervention, on balance it is not strong enough to justify reams of new rules. Tie hedge funds up in too much red tape and they will lose the very characteristics that have made them useful as well as popular. And it is not as if the funds are entirely unobserved. They are subject to anti-fraud law. Moreover, the banks that lend to them and the brokers that allow them to leverage their trading positions all have a keen interest in knowing their customers.

Keeping watch

Such a hands-off approach will look awfully complacent when a big hedge fund blows up, or when some hedge-fund scandal hurts small investors. But strict regulation gives no assurance that those things will not happen. More onerous rules could lull investors to the risks of hedge funds rather than keep them wide awake. Nevertheless, the industry should be watched with special care. It is a cliché to say that the best form of investor protection is *caveat emptor*; it is also true. In the case of hedge funds the maxim applies with special force. If they took the trouble to inform themselves, many investors would conclude that hedge funds are not for them.

Investors of all sorts, you have been warned. If you want to take your chances with hedge funds, understand what you are doing—and, if you are a pension-fund trustee, do it with liability insurance tucked into your back pocket. All investments need to be watched. Right now, it seems, hedge funds need to be watched more carefully than most.

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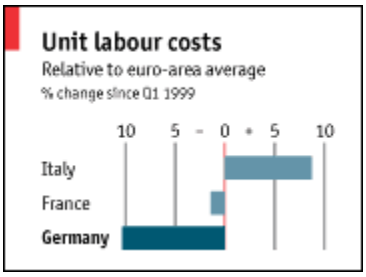
Germany's economy

A view from another planet

Feb 17th 2005
From The Economist print edition

A contrarian view of the German economy

Get article background



NATIONAL stereotypes can become outdated. Some British food today holds its own against French cuisine. Swiss trains do not always run on time. Similarly, Germany's image as the sick man of Europe, with high costs and flabby firms unable to compete in the global marketplace, is now starting to curl at the edges. German business is regaining its vigour.

To make such a claim in the week when new figures showed that Germany's GDP fell by 0.2% in the fourth quarter of last year, leaving output only 0.6% up on a year ago, may seem a touch unworldly. However, coming from a different planet sometimes makes it easier to peer through the conventional wisdom. A Martian landing on Earth today and faced with a choice between investing in America or Germany might well choose the latter.

How can Europe's slowest-growing economy possibly be a good investment? Commentators marvel at the gains in productivity and profits in America in recent years, thanks to firms' aggressive cost-cutting. Yet corporate Germany has made even greater strides to cut costs and improve its competitiveness. A study by Deutsche Bank suggests that Germany's productivity growth has been just as fast as America's since 1995 if both are measured on the same basis. Wages in Germany, however, have grown more slowly, so unit labour costs have fallen. Partly thanks to such pruning, Germany's real trade-weighted exchange rate with the rest of the world (based on relative labour costs) has risen by only 4% since early 2002 despite the surge in the euro against the dollar (see article).

German business is supposedly too flabby to compete in world markets. Yet over the past five years German exports have grown more than three times faster than America's, pushing Germany ahead of America as the world's biggest exporter. Germany is the only G7 country that has increased its share of world exports over the past five years, a period of increasing Chinese competition. America's share of world markets has dropped from 14% to 11%. To our Martian, it might appear that America, not Germany, is the deadbeat economy. Corporate profits have also been rising faster in Germany than in the United States. German equities have outperformed those on Wall Street over the past couple of years, yet p/e ratios suggest that Deutschland Inc looks like an excellent “buy”.

The paradox of thrift

But if German business is in such great shape, why is the country's economy not growing more

strongly. The blame lies with weak consumer spending and business investment, largely as a consequence of the successful efforts of German firms to become fitter. Real wages have been squeezed and workers, fearful of losing their jobs and of looming cuts in welfare benefits, are saving more. Higher profits will eventually encourage new investment and jobs, but the short-term cost is weaker growth. One thing that the government could do to speed up this process is to remove barriers to job creation, especially in services, which are choked by a tangle of red tape.

Some critics also urge Germany to ease its monetary and fiscal policies to boost spending. If only it could: interest rates are set by the European Central Bank on the basis of monetary conditions in the whole of the euro area, not just in Germany; in any case, real interest rates are historically low. Germany could further flout Europe's ill-conceived fiscal rules, run a bigger budget deficit and cut taxes. But households, already worried about how the government will pay their future pensions, might save, not spend, any tax cuts.

Against the 11% of their income put aside by Germans, American households save less than 1%. America's government is also far more spendthrift: adjusted for the economic cycle, its budget deficit is twice as large as Germany's. As a result of inadequate saving, America has a current-account deficit of 6% of GDP. By contrast, Germany has a surplus of 3%. It is true that less saving and more borrowing has propped up consumer spending in America, but one wonders how long that can last. Without higher saving, American investment and hence future living standards will eventually be constrained. In some ways, a Martian might argue, America's economy needs more restructuring than Germany's.

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British politics

What Britain's election ought to be about

Feb 17th 2005
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Public services are what Tony Blair's government should be judged on

Reuters

Get article background

ONE of the few arguments in favour of allowing British prime ministers to choose the date of elections is that campaigns are mercifully short. However, while official electioneering may be confined to a few weeks leading up to the general election expected on May 5th, the unofficial campaign has already started. And pretty depressing it has been too.

Last weekend, the prime minister announced six pledges of numbing vacuity and even dodgier grammar (see article) to counter a similarly prosaic and lightweight offering from the opposition Tories. Meanwhile Labour has attempted (falsely) to depict the Conservatives as intent on swingeing public spending cuts and the Conservatives have attempted (falsely) to depict Labour as soft on immigration. Even more energy has been devoted to the discrediting of the two party leaders: Tony Blair because he “lied” over Iraq's weapons of mass destruction; Michael Howard because he is an unrepentant old Thatcherite on a mission to bring back mass unemployment. With less money and perhaps more sense, the Liberal Democrats have been keeping their powder dry.

Schools and hospitals

It is clear, however, what the election should be about. In 2001 the government promised to bring about the improvements in health care and education that it had failed to deliver in its first four years partly because of scrapping sensible Tory policies. Mr Blair claimed that more money plus reform would bring about a step-change in the quality of public services; he asked to be judged at the next election on how much had been achieved. In health care, the medicine at last seems to be working. Huge amounts of additional cash and new market disciplines are cutting hospital waiting-lists and beginning to deliver some choice of treatment to patients. Whether such spending can be maintained after 2008, when the present commitments end, is a question no party wants to address.

On education, however, the picture is much patchier. Improvements in teaching literacy and numeracy in primary schools were impressive, but have tailed off. Mr Blair bravely attempted to tackle the chronic under-funding of higher education by introducing variable university tuition fees, albeit capped at an unreasonably low £3,000 ($5,700). The biggest remaining problem is the secondary schools attended by 11-to-18-year-olds.

As even ministers admit, progress here has been halting. There are three big defects. The first is that the curriculum and exam systems are over-complicated and increasingly discredited. The second is discipline: it is ragged, particularly in big schools in big cities. The third, root cause of the other two, is structure: local education authorities, backed by egalitarian bureaucrats at the centre, see it as their job to promote fairness rather than excellence. That means, for example, preventing schools from selecting bright and hard-working pupils: better, it is felt, to encourage a mixed intake at every school.

Nice in theory. But like so many attempts at fairness, it achieves the opposite. The system is skewed in favour of wily and wealthy parents who can afford houses that fall in the catchment areas of desirable schools or play bureaucratic games to get their children admitted. Embarrassingly for Mr Blair, social mobility has declined under his government.

The government's approach so far has been a mixture of procrastination, gimmickry and extravagance, setting up, for example, privately sponsored schools in glitzy new buildings, in the hope of improving the state system's image. For the third term, further reform is hinted at. One quick move will be to cut the power of local education authorities, freeing ambitious heads to expand their schools. Another is to “personalise” pupils' education. That could mean anything. Perhaps it will be a way round the taboo against academic selection.

Against these ideas should be weighed the vouchers proposed by the Conservatives. These would be equivalent to the cost of a state education—around £5,000 a year. Private schools would, in theory, then spring up to meet demand from parents dissatisfied with state schools. As it stands, that scheme is flawed and needs improving: parents will not be allowed to top-up the voucher, and private providers will be unenthusiastic about a price cap set by the state. The government's ideas are far more timid; even so, they may be capable of providing more choice and competition among schools than now. Mr Blair's challenge will be to convince voters, after eight years and countless false starts, that choice and competition are what he wants.

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Letters

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From The Economist print edition

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War crimes in Darfur

SIR – I agree that the United States has "little need to fear" the International Criminal Court and should support the court's possible investigation of war crimes in Darfur ("Justice in Darfur", February 5th). Uganda and the Democratic Republic of Congo, among others, have already asked the ICC to investigate atrocities committed within their countries. A referral by the UN Security Council of similar crimes reported from Darfur would ensure a broader, more complete approach in tackling a terrible trend in the region and bring the unscrupulous perpetrators to justice. It could also prove to be a powerful deterrent for future would-be criminals and have a pacifying effect across the whole region—a goal that is in the best interest of the United States.

Fortunately, some insightful US senators have realised this (as evidenced by recent supportive comments from John McCain and Joseph Biden at Davos). It is high time that the stubborn fight the Bush administration is waging against the ICC, a policy based on narrow ideology and irrational fear, is softened and shifted towards a sensible engagement with the court for the benefit of all. After all, it was the United States that provided crucial leadership for international criminal justice after the second world war and, in fact, even during the original drafting of the ICC statute itself.

Reinhart Engelmann
Aloha, Oregon

SIR – The safeguards that you feel should allay the concerns of the United States toward the ICC do not seem all that foolproof. It is likely that an ICC prosecutor will eventually deem it worthwhile to bring one of our presidents to stand trial for war crimes. If we ratified the treaty, but an American court was unwilling or unable to try, say, President Bill Clinton for bombing a Sudanese pharmaceutical factory, America would have to extradite him to stand trial. What would the repercussions be if the seven-judge pre-trial chamber determined that the actions of a sitting president were criminal? The American constitution does not allow such an international check on our executive branch. Thanks, but leave America out.

Todd Sulchek
Oakland, California

Kosovo's Roma

SIR – By far the worst persecution of Roma occurred in Kosovo ("Poor and unloved", February 5th). Most Roma were murderously driven out of their homes by the Kosovars, under the noses of occupying NATO troops. More than five years have elapsed and the Roma still dare not return. As

for the West, it seems far more concerned to placate the Kosovars' demand for independence. So much for the first full-blown experiment in humanitarian intervention.

Yugo Kovach
London

Windows on the world

SIR – Tax the world selling overpriced Microsoft products, amass a private fortune and use it to save millions of lives in poor countries ("Missionary zeal", January 29th). This is absolute genius. Thanks to Bill and Melinda Gates for having more than enough PSR (personal social responsibility) to put their money to good use. But shame on our rich western democracies, apparently unable to use more GSR (government social responsibility) to allocate adequate tax revenues to the same end.

Fabio Poelhekke
Oegstgeest, The Netherlands

SIR – The thought of Mr Gates applying his software-creating skills to developing new medicines makes me wonder. Does this mean that poor countries will be hit with vaccinations that fail to work every so often, prevent compatibility with differing medications, allow other viruses to enter the body and wreak havoc with the system, turn immunisations into a near monopoly and frustrate users daily through over-complexity?

Hanno Langfelder
Munich

Nuclear reaction

SIR – If the circumstantial evidence points to an Iranian nuclear-weapons programme, then the non-proliferation regime has failed yet again, and a diplomatic resolution is doomed ("Jaw-jaw, for now", January 29th). What is as disturbing, however, is the increased chatter from Washington about a possible military strike on Iran. Such a move would have profound repercussions and not just for the Middle East. North Korea, as part of the "axis of evil," would likely conclude that an attack upon it was inevitable. With US forces overextended worldwide and bogged down in Iraq, might it not attack first? It would be a tragic irony if the Bush administration learned the hard way that its favoured policy of pre-emption can cut both ways.

Peter Kurze
Middletown, Rhode Island

Thanks for sharing

SIR – Yochai Benkler's contention that social sharing provides an economic alternative to both markets and the state sounds both novel and obscure (Economics focus, February 5th). Yet the principle of "usufruct", which allows resources to be used by any individual provided he or she leaves them in at least as good a state as they were given, can be found in ancient Roman law. Commons regimes (where local communities share the use of common land through rationing, so replenishing their resources without eroding them) are found throughout history and across four continents. Such sharing provides a way of restoring economics back to its original promise as a science that finds ways of matching scarce resources with unlimited human wants. In other words, while there may be no such thing as a free lunch, you can use my crockery as long as you wash and dry.

Derek Wall
Windsor, Berkshire

SIR – You say that Mr Benkler “identified an intriguing alternative”. But the economics of sharing sounds suspiciously like communism to me.

Ranko Bon
Motovun, Croatia

Germany at play

SIR – You conclude, from low sales of digital games, that Germans are uninterested in games of all kinds (“Reasons to be playful”, January 29th). However, Germany is the world leader in board games: sales per person are higher than in any other country. Enthusiasts elsewhere look with envy on the highly competitive excellence of German board games. The key is in the culture: board games have the advantage that they are playable by the whole family, while most video games are solitary exercises. As networked digital games that enable multi-player scenarios begin to spread, it is likely that German enthusiasm for playing those games will rise.

Greg Costikyan
New York

Pearls of wisdom

SIR – As a baseball fan, I was pleased to see that Yogi Berra was named the wisest fool (“Wisest fools”, January 29th). But he might quibble with your choice. In response to a question about his aphorisms, he replied, “I didn't really say everything I said”.

Chris Gondek
Portland, Oregon

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Anti-Americanism

The view from abroad

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From The Economist print edition

George Bush will encounter a more complex animosity than is often portrayed when he ventures abroad next week

EVER since the days of the Founding Fathers, America has regarded what George Washington called “the foreign world” with a degree of suspicion, and the foreign world has often reciprocated. Never more than now, it seems. Under George Bush, anti-Americanism is widely thought to have reached new heights—and, in the view of the Pew Research Centre, a Washington surveyor of world opinion, new depths. Its latest report says that “anti-Americanism is deeper and broader now than at any time in modern history.” But though anti-Americanism spans the globe, the phenomenon is not everywhere the same. It mutates according to local conditions, and it is seldom straightforward.

No wonder. Most people's feelings about America are complicated. “America”, after all, is shorthand for many other terms: the Bush administration, a Republican-dominated Congress, Hollywood, a source of investment, a place to go to study, a land of economic opportunity, a big regional power, the big world power, a particular policy, the memory of something once done by the United States, a set of political values based on freedom, democracy and economic liberalism, and so on. It is easy to be for some of these and against others, and some may wax or wane in importance according to time, circumstance, propaganda or wishful thinking. So it should be no surprise that some people can hold two apparently contradictory views of America at once. The incandescent third-world demonstrator, shrieking “Down with America!” in one breath and “Can you get me a green card?” in the next, has become a commonplace.

As Mr Bush may discover when he meets his French counterpart over dinner on Monday, no country contains this mixture of attitudes in greater abundance than France. France is a longstanding ally of the United States (since 1778); it gave America the Statue of Liberty; it

conferred honorary citizenship on Madison; it was the country of Lafayette (American revolutionary hero), of Montesquieu (profound influence on Jefferson) and of L'Enfant (designer of Washington, DC). Yet France is also the country that rails against American *hyperpuissance* (hyperpowerdom), cheers when rustic thugs lay waste McDonald's and laps up books like “11 Septembre 2001: l'Effroyable Imposture”, whose thesis, that the attacks on the twin towers were “an appalling deception” to justify American adventurism, won it sales of 100,000 in its first week of publication. France, moreover, is the home of Gaullism, a form of nationalism saturated with anti-American bilge—and the well-spring of Mr Chirac's political creed.

All this has made France the *locus classicus* of anti-Americanism. Yet many ordinary French people, as distinct from their more politically-minded countrymen, are rather pro-American. They go to American movies, take holidays in the United States, eat in McDonald's (rustics permitting) and shop in places that look much like American giant stores. In a poll conducted in 21 countries by the BBC World Service last month, only a small majority (54%) of those interviewed in France said they viewed American influence unfavourably—not much more than in Australia (52%), and rather less than in Mexico (57%), Canada (60%) and Germany (64%).

The repulsion of similars

So what explains France's reputation for anti-Americanism? The main answer is that it is proclaimed bombastically by so many of those in France who strike political attitudes. They do this partly because of the rivalry between France and America, based on their remarkably similar self-images: the two countries both think they invented the rights of man, have a unique calling to spread liberty round the world and hold a variety of other attributes that make them utterly and admirably exceptional. Jealousy also plays a part. America is often better than France at activities that the French take great pride in, such as making movies or even cooking—at least if popular taste is the judge. And French politicians are not blind to the value of criticising someone else in order to divert attention from their own failures: French anti-Americanism tends to rise when France has just suffered a setback of some kind, whether defeat at the hands of the Germans, a drubbing in Algeria or the breakdown of the Fourth Republic.

Not many countries share all these characteristics, but several have some of them. Take Iran, where political diatribes, religious sermons, rent-a-mob demonstrations and heroic graffiti regularly denounce the Great Satan and all his doings. Anti-Americanism is central to the ideology of Iran's ruling Shia clerics. Yet Iranians at large, like the French, are not noticeably hostile to America. The young in particular seem thoroughly pro-American, revelling in America's popular culture, yearning for its sexual freedoms, some even hoping for an American deliverance from their oppression. Whether the affection runs deep is another matter: pro-Americanism among the young is a form of anti-regime defiance that might evaporate quickly if their country were attacked.

Great Satan cramps Little Satan

Yet why should the clerics bang on so relentlessly about the United States when the British were just as deeply involved in the overthrow of Mohammed Mossadegh's regime in 1953, when Iraq under Saddam Hussein posed a much greater threat, and when, recently at least, America has shown itself ready to get rid of the Baathists next door and pave the way for a Shia-led government in Iraq? The main explanation, as in France, is rivalry. Iran's theocratic regime has clear ambitions to be a leader not

just of the Middle East but of the entire Muslim world. America, now avowedly bent on spreading democracy across the region, is in the way.

The regime has other reasons as well, no doubt: to divert attention from its many failures; to keep alive the thought that the wicked shah, restored to power in the 1953 coup, was the creature of the Americans, even though memories of his rule glow ever more brightly for many older Iranians; and, inevitably, to exploit the widespread feeling among Muslims almost everywhere that the United States is pro-Israel, anti-Palestine and indeed anti-Islam, a feeling that has intensified, according to the polls, since September 11th 2001. Pew says anti-Americanism is nowhere more acute than in the Muslim world.

Even here, though, the picture is not uniform. In Indonesia, the biggest Muslim country, anti-Americanism is largely an armchair affair. People are happy to curse the United States—a current rumour suggests it could have given warning of the December tsunami but chose not to—yet none of the recent terrorist attacks in Indonesia seems to have been directed at Americans. In Arab countries, by contrast, some people are clearly ready to take up arms in pursuit of al-Qaeda's *jihad*.

Arab anti-Americanism is a much younger phenomenon than its European counterpart

Arab anti-Americanism is a much younger phenomenon than its European counterpart. Although it shares with European left-wingery much claptrap about the wickedness of American materialism, it became widespread in the Middle East only with America's open support for Israel after the 1967 six-day war. Eleven years earlier, Arabs had been all for the United States: it had just put a stop to the Suez affair, the British-French-Israeli attempt to overthrow the Nasser regime in Egypt. But since 1967 America has been considered by Arabs to be incomprehensibly pro-Israeli. The potency of this view probably owes more to Arab failures than to anything else—failures to deal with Israel, to establish democracies, to create modern economies, to produce heroes in virtually any field of respectable human endeavour. This must be someone's fault. Whose? Why, the local thug (Israel) and its sponsor (America), of course.

A seminal event, akin to the 1967 war for Arabs, may be found in plenty of other places where anti-Americanism flourishes. In Greece it was America's backing for the rule of the colonels (1967-74). In Spain, it was the support—implicit, if not explicit—of the Franco regime that came with America's military bases in the 1950s. Some say Spain's dislike for America dates back to the Spanish-American war of 1898, but in truth that made little impact on the left, which saw the war as an agent of Spain's modernisation. When American soldiers arrived at Torrejón and other bases in the 1950s, though, the Spanish left saw them as collaborators, not liberators.

Most of the far left in Europe is still anti-American, for familiar reasons: America is materialist, imperialist, interventionist, etc. But right-wingers, too, are sometimes hostile. The ideas of the American revolution have inevitably challenged *anciens régimes* and anti-democrats of any stripe (including Franco's, until the bases). As conservatives have come to terms with democracy, those who have taken against America have done so mostly for snobbish or cultural reasons: hence the antagonism of such British writers as Evelyn Waugh and Kingsley Amis.

Latin Americans may think they have better reasons to harbour a grudge. Mexico, for instance, lost about half its territory to the United States in the war of 1846-48. In the BBC survey last month, only 11% of the Mexicans polled had a mainly favourable view of the influence of their northern neighbour, less even than the proportion of Argentines, who are in other respects even more hostile. Cubans have resented the United States ever since 1898, when their hard- and long-fought war of independence against Spain was in effect stolen from them by the y*anquis* prosecuting the Spanish-American war. The United States then made some 30 military interventions in and around the Caribbean in the next 30 years, many of them under Smedley Butler, a marine corps general, who summed up his career thus:

> I helped make Honduras “right” for American fruit companies in 1903. I helped make Mexico...safe for American oil interests in 1914. I helped make Haiti and Cuba a decent place for the National City Bank boys to collect revenues in. I helped in the raping of half a dozen Central American republics for the benefit of Wall Street...I helped purify Nicaragua for the international banking house of Brown Brothers in 1909-12. I brought light to the Dominican Republic for American sugar interests in 1916. In China, I helped to see to it that Standard Oil went its way unmolested.

For most of the 19th century, Latin Americans—including their great liberator, Simón Bolívar—had drawn inspiration from the American colonists' anti-British revolt. But the war of 1898 and the interventions that followed turned most of them against the great power next door. The hostility remains, in varying degrees, though 15 years of democratisation, emigration to and trade with the United States have done much to soften attitudes, especially in Central America.

Other nations that have experienced American meddling also continue to resent it. For evidence, just go to Congo, where Mobutu Sese Seko ruled imperiously for decades courtesy of the United States, or to Angola, whose long wars were drawn out by the superpower sponsorship of its local tyrants. Yet anti-Americanism in such places does not seem to run deep. This is not just a matter of distance. The Philippines is hardly adjacent, yet its experience as an American colony for half a century has left it with a persistent strain of anti-Americanism—as well as an infatuation, among the young at least, with basketball and country music.

Proximity makes the heart grow colder

That suggests that the intensity of the American experience may be the decisive factor in the creation of lasting anti-Americanism. It would explain why Indians, for instance, though their governments were long hostile to America in foreign policy, have never shown much antagonism in other ways. Yet the intensity test certainly does not provide an iron rule. On the one hand, Canada, which has never suffered anything worse from its neighbour than cultural imperialism, ignoration and disdain, is perpetually critical of the United States. If it were not—if it did not define itself in opposition to its neighbour—Canada, it seems, would have no reason to exist. On the other hand, Vietnam, less than 30 years after a long war against the Americans in which it lost about 5m of its people, seems to harbour little hostility towards its old foe. Perhaps it is just too busy to hate.

It may help, too, that Vietnam has not had any subsequent reason, real or imaginary, to resent America. In many of the places where the embers of anti-Americanism burn brightest, some event has taken place to rekindle them. For Arabs, the war in Iraq is one. For Latin Americans, it was the United States' support for Augusto Pinochet's coup in Chile (and now its stomp-all-over-the-place war on drugs). For Greeks, it was the American-led interventions in Bosnia and Kosovo—interventions on behalf of Muslims, though many Muslims seem to forget it. The Greeks, though, did not. They were outraged by NATO's attacks on the Serbs, another Orthodox Christian people. In the Philippines, America was considered far too friendly to the kleptocratic and ruthless

Ferdinand Marcos. In every country with American bases, any outrage by American servicemen—the rape of a Japanese child, the running over of two South Korean girls, the severing of an Italian cable-car's wires—tends to strengthen latent hostility.

The vigour of anti-American feeling varies strongly even among peoples who, to the casual observer, seem to have no good reason for their differing reactions. The Japanese, for example, defeated in war—Tokyo fire-bombed, Hiroshima and Nagasaki triturated with atomic bombs—seem far more pro-American than the South Koreans, who owe much of their freedom to American force of arms. Why? Perhaps because the Japanese feel, rightly or wrongly, much more threatened by China and North Korea than do the South Koreans, and are therefore much more grateful to a protective Uncle Sam.

Certainly, hostility to America is often mitigated by feelings of friendship and gratitude. Plenty of elderly Frenchmen remember America's role in liberating their country. Plenty of Germans remember the Berlin airlift. Plenty of elderly Iranians are proud that they once studied in the United States. Many, if not most, of the reformist democrats in Latin American governments have been to American universities, as have several of their east and central European counterparts.

Hostility to America is often mitigated by feelings of friendship and gratitude

An American diaspora may also have a mollifying effect in the old country. France, which has sent few emigrants to North America since before the European Enlightenment, is unusual in providing no hyphenated Americans (which may help to explain why French anti-Americanism is matched by American anti-Frenchism). Huge communities of Latin Americans, Indochinese, Greeks, Koreans, Iranians, you name it, have grown up in recent decades in the United States and ensure that a constant flow of money, ideas and hope flow from America to other parts of the world.

This background of ties, aspirations and shared values means that in some places anti-Americanism can be dissipated quite quickly with a visit (such as Bill Clinton's trip to India in 2000) or some other gesture (debt forgiveness perhaps, or some post-tsunami assistance). In other places, though, it would take much more to change attitudes: an American-engineered peace between Israel and the Palestinians, say, or a credible commitment to tackle global warming, and even these might prove ineffective without other policy changes sustained over many years. And in some places it may well be impossible for America to do very much. The mere fact of being a great power ready to intervene (in, say, Kosovo) is enough to make enemies. And then some states, like some people, have chips on their shoulders. Anti-Americanism in Argentina and parts of the Arab world has as much to do with the inadequacies of these countries as with anything done by the United States.

Why, anyway, should America care if a bunch of foreigners dislike it, or affect to? Maybe, as a military and economic power without rival, it should not be too worried. Yet America needs the co-operation of other governments if it is to conduct trade, combat drugs, reduce pollution and fight terrorism. Moreover, Mr Bush is now committed to spreading “freedom” across the Middle East, indeed across the world. If foreigners, disillusioned with America, believe this is merely a hypocritical justification for getting rid of regimes he dislikes, the task may be harder. It is striking that Mr Bush's 49 mentions of liberty or freedom in his inaugural address last month do not seem to have struck the sort of chord round the world that Jack Kennedy's quixotic commitments did in the 1960s.

Shining city loses lustre

That may reflect the greater cynicism of the worldwide audience 40 years on. But the polls suggest it also has something to do with Mr Bush. Last month's BBC poll found that opposition to

Mr Bush was stronger than anti-Americanism in general, and that the particular had contributed to the general. Asked how Mr Bush's election had affected their views of the American people, 42% said it had made them feel worse towards Americans.

That is the, perhaps short-term, view of some non-Americans. It is accompanied by another view, increasingly common among pundits, which holds that America is losing its allure as a model society. Whereas much of the rest of the world once looked to the United States as a beacon, it is argued, non-Americans are now turning away. Democrats in Europe and elsewhere who once thought religiosity, a belief in capital punishment and rank hostility to the United Nations were intermittent or diminishing features of the United States now see them as rising and perhaps permanent. Such feelings have been fortified by Mr Bush's doctrine of preventive war, Guantánamo, opposition to the world criminal court and a host of other international agreements. One way or another, it is said, people are turning off America, not so much to hate it as to look for other examples to follow—even Europe's. If true, that could be even more insulting to Americans than the rise in the familiar anti-Americanism of yesteryear.

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Tort reform

Skewering the lawyers

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Congress deals a blow to class actions—but the basic tort system is unchanged

DICKIE SCRUGGS, a Mississippi trial lawyer who led the charge against Big Tobacco in the 1990s, helping 46 states win a $246 billion settlement, once described the features of a “magic jurisdiction” in America's tort system. Speaking at an asbestos conference in 2002, he said that such a place would have judges elected with “verdict money”, trial lawyers who were cosy with those judges, and huge numbers of voters “in on the deal”. In this trial lawyers' paradise, “cases aren't won in the courtroom,” Mr Scruggs assured his audience. “They're won on the back roads long before the case goes to trial.”

In the view of corporate America, many doctors and George Bush's Republican Party, there are too many magic jurisdictions in America. Places like Madison County, Illinois, have become famous for awarding large punitive damages and for cosy relationships between trial lawyers and judges. They thus become magnets for class-action lawsuits, which bundle hundreds—even hundreds of thousands—of small claims that would not justify the costs of a stand-alone case. These suits have surged in Madison County from just two in 1998 to 106 in 2003.

Trial lawyers and Democrats have long protested that Big Business is exaggerating the woes of America's tort system in order to tilt the system in favour of rich defendants. If so, this dastardly plan is certainly working. On February 10th, the Senate approved by 72 votes to 26 the Class Action Fairness Act, which is designed to push class-action suits away from places like Madison County to the fairer federal system. As *The Economist* went to press, it looked as if the House would pass the bill too, giving Mr Bush a chance to sign it into law when he returns from Europe.

One for the president

In political terms, this is a big victory for Mr Bush, who pushed class-action reform in his re-election campaign. He can also boast bipartisan support: 18 Democratic senators deserted the lawyers' lobby, which has given their party so much. Indeed, in general the lawyers were out-muscled by the US Chamber of Commerce, which cleverly focused its fire on the former Democratic minority leader, Tom Daschle, last November, forcing this blocker of tort reform out of his seat in South Dakota.

Mr Bush and his business allies are now keen to move on to the other two parts of his tort-reform plan: sorting out the asbestos-litigation mess and medical-liability reform. But what exactly will this week's new measure achieve? Opinion, inevitably, is split between lawyers, who think it goes too far, and reformers, who wish it had gone much further.

The bill hits trial lawyers in their pockets, by limiting their fees to a proportion of the amount of money the plaintiffs actually collect rather than the theoretical amount awarded to them, if the award is in coupons rather than cash. (In a big case, companies often compensate plaintiffs with coupons, which are either fiddly or too small to redeem.)

But the bill's main aim is to stop “forum-shopping”—looking for magic jurisdictions. It says that any big class action (one that has more than 100 plaintiffs and more than $5m at stake) must go to federal court. An important exception, won by Democrats, ensures that a class-action suit must be filed in a state court if the chief defendant and at least two-thirds of the plaintiffs come from that state.

Part of the debate about the effect of the new bill still revolves around how bad forum-shopping actually was. Democrats protest that “judicial-hellhole” states usually tidy up their act sooner or later: eight have recently passed laws making class actions harder to file. Republicans reply that barely has one hellhole been closed than another opens up elsewhere. The merry-go-round has moved from Alabama and Texas to Mississippi and now to southern Illinois and West Virginia.

Looking forward, both sides agree that it will be virtually impossible now to get a nationwide class-action suit off the ground. The bill, if passed, would bar such suits from being filed in state courts. Meanwhile, federal judges face all sorts of constraints before they can certify multi-state suits. Consumer-protection law, often the basis of class-action suits, varies too much from state to state, and is often vague.

Some exceptions exist: securities-law class actions, for instance, are dealt with at the federal level. But lawyers whinge that the federal courts are generally kinder (or less tough) on defendants than places like Madison County. And there is also a huge backlog in federal cases. Federal judges, who opposed the bill because they were overburdened, may well decide to give civil class actions a far lower priority than criminal cases or lazily dismiss them on technicalities.

All this explains why the new Senate Minority Leader, Harry Reid, claims that the bill “slams the courthouse door on a wide range of injured plaintiffs.” But wait a moment. The new law still leaves open the possibility for single-state class actions in state courts; the minimum requirement for in-state plaintiffs is quite low. George Priest of Yale Law School says that trial lawyers will simply duplicate their actions, filing simultaneous class actions in separate state courts if they are forbidden to bundle them together.

Less tough than it looks

Indeed, the claim that this is the toughest tort-reform package in a decade is no great boast. Since trial lawyers have kept all chance of reform locked in their vice-like grip, there is virtually nothing to compare it with. The new law may well restrict the number of class-action lawsuits, but it does nothing about the underlying principles of the tort system, especially the ability to sue for punitive damages (on top of the actual compensatory damages suffered for the victim) and the fact that those punitive damages, which tend to be the spectacular ones, are shared by the victims and their lawyers.

A more radical plan might simply have changed the system to remove the punitive incentive to sue—for instance, by paying all punitive damages to the state in the form of a fine for bad behaviour. In the absence of such fundamental change, a lot still depends on whether Mr Bush can push through his other two proposals.

In the case of asbestos, various lawsuits on behalf of victims have bankrupted more than 70 companies. The Republican solution is to establish a $140 billion industry-backed trust fund to settle all the claims in exchange for ending all litigation. Unfortunately, the consensus to do this is “eroding very fast”, says Michael Greve of the American Enterprise Institute. One problem is a brawl between insurers and manufacturers: each wants the other to pay more into the fund. Conservatives also worry that trial lawyers will get a cut.

With medical-liability cases, Mr Bush wants to cap awards for “pain and suffering”, which are given after patients have been reimbursed for lost earnings and medical expenses, at $250,000. That would bring some certainty to doctors, but it strikes many people as too low a limit for botched operations, so Mr Bush may have to compromise. Even if they get most of what they want, the Republicans will merely have curbed the more outrageous abuses; they will not have pushed through structural reform.

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Episcopalians at sea

God help them

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Widening divisions at the top of a faltering church

WHEN the world's Anglican bishops meet in Belfast on February 21st, brotherly love will be in scant supply. The Anglican church has been in turmoil since its American leaders appointed Gene Robinson, an openly gay man, to be bishop of New Hampshire in 2003. It hasn't helped that America's bishops are considering blessing same-sex unions. Outraged, about 60% of the world's Anglican provinces have cut or loosened their ties to the Episcopal church, America's version of Anglicanism. But nowhere is conflict more heated than in America itself.

In January, Episcopal bishops clashed at a two-day meeting in Salt Lake City. The focus was last autumn's Windsor report, which called for moratoriums on the blessing of same-sex unions and the ordination of gays "until some new consensus in the Anglican Communion emerges". Neither a moratorium nor a consensus appeared. Episcopal leaders refused to condemn the ordination or union of gays, but expressed "regret" for dividing the church. Conservative bishops snapped that such an apology was worthless—one compared it to a man apologising to his wife for having an adulterous affair, "but then continuing on with the illicit affair anyway".

While leaders bicker, America's 2.3m Episcopalians are taking sides. Conservatives are indignantly rejecting the term "Episcopal" and calling themselves "Anglicans". In Manhattan, St George's church has subtly purged the word "Episcopal" from its printed programme after more than 250 years of Episcopal services. Other churches are more radical: ten dioceses have joined the Anglican Communion Network, a conservative sect that claims the Episcopal church has "abandoned 2,000 years of biblical teaching and historical church order".

In some states, conflict has degenerated into an all-out brawl. Three churches in Los Angeles have denounced the Episcopal church and affiliated themselves with an Anglican diocese in Uganda. The LA diocese, in turn, is suing to reclaim its property. A Virginia state senator is promoting a bill that would allow a congregation to leave a denomination and take the church building with it. In Pennsylvania, a liberal parish is staging a counter-revolution to sack its conservative "Anglican" bishop.

Frank Griswold, the presiding bishop of the Episcopal church, is the man who must deal with this mess. Not only are congregations in chaos, but donations are falling. This month, the Episcopal church treasurer noted that local diocesan giving had dropped by 12% since 2003, when Mr Griswold helped appoint Mr Robinson bishop. The legal fights over property are not helping the church's finances either.

Mr Griswold is standing his ground, and he has many supporters. At the January meeting, he and his allies expressed their "commitment to the interdependence of this church as a member of the Anglican Communion". Nevertheless, the Windsor report concluded that unless one party makes a big change, the church's factions may choose to "walk apart". Reconciliation in Belfast would be a

miracle.

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Faith-based initiatives

Compassion fatigue?

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Whatever happened to compassionate conservatism? More than you think

DOES the Bush administration really mean what it says? The question usually comes up in the context of big issues—like Iraq or Social Security. But the neglected matter of compassionate conservatism is not a bad yardstick either.

Back in 2000, George Bush defined himself as a compassionate conservative. This was partly a matter of branding: he softened the image of his party by talking about spending more money on education and health. But compassionate conservatism was also presented as a new (and, controversially, religious) way to help the poor: its aim was to use public money and private donations to involve churches, temples and mosques in America's social policy.

Yet compassionate conservatism has been inadequately financed, not supported by any real political commitment and representative of a huge gap between the president's rhetoric and practice. And that is the view not of some secular Democrat but of the former number two in the White House office supposed to be making compassionate conservatism a reality.

This week, David Kuo, the former deputy director of the White House's Office of Faith-Based and Community Initiatives, argued in Beliefnet.com, a religious website, that Mr Bush's "promises remain unfulfilled in spirit and in fact". Mr Bush, he points out, originally talked of finding $8 billion a year for "the armies of compassion". In practice, the programme has got nothing like that. For example, the office was supposed to set up a $200m Compassion Capital Fund; so far it has made grants of only $100m.

The president, claims Mr Kuo, could have pushed his policies through. It is true that most Republicans on Capitol Hill were indifferent, and most Democrats hostile. But Mr Bush overcame stiffer resistance on other issues, such as prescription-drug benefits. The most important bit of compassionate conservatism—tax breaks to encourage charitable giving—could have been implemented as part of the 2001 tax cuts. But this was dropped from the bill because the White House preferred to repeal the estate tax and could not afford both. The bottom line, argues Mr Kuo, is that the White House "never really wanted the 'poor people stuff'".

This is not the first time a member of the "faith-based" office has blown the whistle. Its first director, John DiIulio, resigned in 2001 and made a similar charge: that the administration wanted the issue (which is electorally attractive) more than it wanted the policy (which raises controversies about the division between church and state).

There is not much doubt that the policy has failed to live up to the billing that Mr Bush gave it in 2000. But it is not true that nothing is happening.

Last year, Congress approved nearly $250m for the main spending programmes (of which the

Compassion Capital Fund is one). This year, the administration is asking for $385m. It also wants tax breaks worth $4.4 billion—nothing like the amount first mooted but not peanuts. Compassionate conservatism has not so much vanished as lost the limelight.

Mr Bush could certainly have done more, but he has not given up. As Michael Cromartie, a member of the president's commission on international religious freedom, points out, the timing of Mr Kuo's criticism is awkward—and misleading. This week, Jim Towey, Mr DiIulio's replacement as head of the faith-based office, started a charm offensive with senators and heads of government agencies, apparently as the first stage in a new attempt to get a “faith-based” bill through Congress. Mike Gerson, the president's respected former speechwriter, has been put in charge of the policy.

There is no guarantee it will succeed, of course. But perhaps Mr Kuo's criticisms will end up invigorating the agenda, rather than marking its demise.

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Eminent domain

Despotism by stealth

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You think America is a land where individualism holds sway and private property is sacrosanct? Next week, the Supreme Court decides whether that is true

NEW LONDON is an old Connecticut whaling town halfway between New York and Boston. The day before Thanksgiving 1998, Susette Kelo, a registered nurse, got an unwelcome holiday gift: an eviction order. Her house, and those of six other families living on an abandoned submarine base called Fort Trumbull, had been compulsorily purchased. She had five months to get out.

What is unusual about this is that her house is no rat-infested health hazard. She bought and spruced it up three years before. Nor is it being seized by a branch of government: the evictor is the New London Development Corporation (NLDC), a private non-profit body. The land is not going to be used for a public works project, such as a bridge or school. Indeed, it is not certain what her land is wanted for.

New London is trying to turn itself into a biotech hub. In 2000, it persuaded Pfizer to build its global research centre there. Now it wants Fort Trumbull for a biotech park, complete with hotel and fancy houses. Writs are flying. The residents accuse the NLDC of behaving like the Gestapo, pointing bulldozers at their front doors, surrounding an old lady's house with klieg lights and using deafening stone-crushing equipment in their backyards. The NLDC accuses the homeowners, who have less than two acres of land, of holding up a 90-acre development that would transform the city. In March 2004, the Connecticut Supreme Court ruled in the NLDC's favour by a 4-3 margin.

The case is now a celebrated one. Three of America's largest pressure groups, the AARP, the NAACP and Martin Luther King's Southern Christian Leadership Conference, have lined up behind Mrs Kelo. New London has the backing of practically every local-government umbrella-group as well as New York and the American Planning Association. The case has divided the Republican coalition, with defenders of private property rights and small-government types on one side, and big business and development interests on the other.

On February 22nd, these two juggernauts collide at the Supreme Court when it hears *Kelo v City of New London*. The case marks the biggest test for 50 years of “eminent domain” (or “compulsory purchase” as it is more accurately called in Britain).

This sounds technical, but it involves fundamental issues. When may the government overrule private property rights for the sake of the public good? What constitutes “the public good” in such a case? Does it make any difference whether that good is delivered by a public or a private entity? George Will, a conservative columnist, has even suggested that allowing the government to seize a person's home on the grounds that it can make better use of the property is creeping despotism.

Most people accept that private property rights should not be absolute. Mad grandpa in his tumbledown shack can be evicted so a school can be built. But the power to take over private

assets in the public interest must be constrained. The constitution does this by saying that private property shall not “be taken for public use, without just compensation”. State constitutions follow that wording.

The blighted and the condemned

But what is “public use”? In the classic examples—roads and schools—it refers to entities that are publicly owned and which benefit everyone. But in 1954, the Supreme Court ruled in *Berman v Parker* that private projects meet the definition if they have a “public purpose”. The court approved a slum-clearance plan of the government of Washington, DC, over the objections of a local department-store owner. In the 1960s and 1970s, local governments often declared unsafe slums to be “blighted” and used the power of eminent domain to buy out people in the way.

Since then, two things have changed. First, definitions of “blight” have broadened. Lakewood, Ohio, condemned well-kept historic homes for being “functionally and economically obsolete”. In Lancaster, California, the city government condemned a discount store on the basis that a neighbouring retail giant, Costco, wanted to expand into it. “Blight” meant, in effect, making room for properties that would pay more tax revenue.

Second, local authorities have given up relying on blight at all. In 1981, the Michigan Supreme Court let the city of Detroit raze a working-class Polish neighbourhood, Poletown, so that General Motors could build a new Cadillac plant. The city did not condemn Poletown as blighted; it merely said a car plant would generate more taxes and jobs than a Polish neighbourhood. In this case, “public use” became something like “economic benefit”: private property may be taken if it obstructs a community's development.

New London did not use a blight designation. And Connecticut's Supreme Court said the economic benefits did not have to be substantial and certain (as had been required in Michigan). New London could condemn a property without knowing exactly how it was going to be used.

Defenders of eminent domain argue that these are logical developments, that courts have approved each step and that if voters dislike the outcome, then they can always vote the bums out. The last point is debatable in this case, because the city of New London has delegated its power of eminent domain to the NLDC. But the Supreme Court has traditionally given deference to local governments in local issues.

More broadly, argue the defenders, development in tough spots would stop without eminent domain. New London was dying before Pfizer put its research centre there. The new development, says the NLDC, would generate 1,000 jobs and up to $1.3m in annual taxes: who are seven people, who have anyway been offered compensation, to stand in the way?

Eminent domain has helped many big cities bounce back from decline. New York's Times Square is a good example: before eminent-domain purchases, 42nd Street was in poor shape. Shops now want to be huge (think Wal-Mart, or, indeed, Costco). Cities that have reinvented themselves as downtown malls, such as Indianapolis, have had to use eminent domain to acquire big enough sites. Otherwise, the shops would have fled to the suburbs.

Opponents reply that the system is not so much necessary as out of control. The Institute for Justice, which is arguing for Mrs Kelo in the Supreme Court, has combed through newspaper reports to count over 10,000 examples in which “eminent domain” condemnations have been used or threatened in 1998-2002—and that is just a fraction of the total.

They also dispute the claims that the courts have approved each step. Rather, they say, there is legal uncertainty. Last July, the Michigan Supreme Court reversed its “Poletown” decision, admitting the original was a “radical departure from fundamental constitutional principles”. And while a dozen states frequently use eminent domain for economic development, a dozen specifically ban or discourage it—with little evidence of harm. Georgia has seen no eminent-domain cases in the past seven years; Atlanta is overwhelmed by growth. Washington state forbids the practice for private development; Seattle has won a stack of awards.

The opponents say they do not want to get rid of eminent domain—just to tie its use back to a meaningful definition of blight. Put simply, cities cannot take someone's house just because they think they can make better use of it.

Otherwise, argues Scott Bullock, Mrs Kelo's lawyer, you end up destroying private property rights altogether. For if the sole yardstick is economic benefit, any house can be replaced at any time by a business or shop (because they usually produce more tax revenues). Moreover, if city governments can seize private property by claiming a public benefit which they themselves determine, where do they stop? If they decide it is in the public interest to encourage locally-owned shops, what would prevent them compulsorily closing megastores, or vice versa? This is central planning.

The Supreme Court will announce its decision in the summer. For local governments, it could change the way they develop towns. For private-property defenders, it could decide whether there any constitutional restrictions on eminent domain. And for Mrs Kelo and her neighbours, it will “merely” determine whether they can continue to own the houses which some of them have lived in since they were born.

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Lexington

The old slur

Feb 17th 2005
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Anti-Americanism, the American left and the American right

THERE is no thunderbolt that the American right likes hurling at its foes more than the accusation of “anti-Americanism”. Most of its targets are foreigners (see article). But, from the right's point of view, there are plenty of unAmerican leftists at home too. Conservative congressmen labour over laws to prevent leftists from burning the American flag. Conservative talk-show hosts are for ever uncovering anti-Americanism at Harvard or on National Public Radio. And conservative activists are forever shouting at liberals: “Why don't you move to France?”

Many foreigners might assume that charges of unAmerican behaviour went out with Joe McCarthy. But the past few weeks have already produced two much-discussed examples. First, the right foamed at the mouth over Ward Churchill, a professor of ethnic studies at the University of Colorado, when it discovered, somewhat belatedly, that he had written an article on the day after September 11th that described the victims of the atrocity as “little Eichmanns”. (“True enough, they were civilians of a sort,” the Boulder professor had opined, “But innocent? Gimme a break.”) Then the right foamed again about the revelation that Eason Jordan, CNN's chief news executive, had supposedly told a group of bigwigs at Davos that the American army was deliberately targeting journalists to kill them; he denies he said this, but admits he left the wrong impression.

Mr Jordan, who even under the worst interpretation was probably just sucking up to a group of glamorous foreigners rather than expressing any deeply held philosophy, has now resigned. Mr Churchill, being an academic, still has a job. But how widespread is domestic anti-Americanism? Is

it really a doctrine that pervades the American left, as many conservatives charge? Or is it an eccentric phenomenon blown out of proportion by a vicious conservative attack-machine?

The right has two powerful arguments on its side. The first is that leftists, from the Rosenbergs and Alger Hiss to John Walker Lindh (the Marin County-bred “American Taliban”), have been caught doing treasonous things. Lynne Stewart, a well-known radical lawyer, has just been convicted of helping one of her clients, Sheik Omar Abdel Rahman, to contact his supporters—an action that could put her in prison for around 20 years.

More generally, prominent leftists have indulged in language which, at the very least, is extremely critical of their country. Back in 1969, Susan Sontag reflected that “it is self-evident that the *Reader's Digest* and Lawrence Welk and Hilton Hotels are organically connected with the Special Forces napalming villages in Guatemala”; after September 11th, she interpreted the outrage as “an attack on the world's self-proclaimed superpower, undertaken as a consequence of specific American alliances and actions.” Michael Moore has compared Iraqi terrorists to Minutemen and said modern Americans are the stupidest and greediest people on the face of the Earth.

Comrades Sontag and Moore would insist that they were opposed to American foreign policy, not America; but, to put it mildly, they were pushing it. They also represent a private tradition on the American left of rubbishing their countrymen as vulgar morons, especially when set alongside sophisticated Europeans. (If you doubt this, don a tweed jacket, assume a British accent, invite yourself to a dinner party in an American university town and wait until the Pinot Grigio takes hold.)

So anti-Americanism does exist on the left, but it is hardly its exclusive preserve. There are plenty of loud-mouth critics of American policy on the right. The *American Conservative* is as rude about American imperialism and the Iraq war as the *Nation*—but nobody really accuses Pat Buchanan of anti-Americanism. As for dismissing American culture, Mr Moore is less acerbic than one of the right's patron saints, H.L. Mencken. The *Public Interest* and the *New Criterion* worry about popular culture. Robert Bork thinks America is slouching towards Gomorrah. Pat Robertson and Jerry Falwell agreed that September 11th was a punishment for America's liberalism on abortion and homosexuality. Was that less anti-American than Ms Sontag?

By the left, quick march

Moreover, the odd thing about the American left—at least from an international perspective—is how caught up it is in passion for America. It is hard to think of any foreign left-of-centre party that would brandish the flag as often as the Democrats did in last year's election campaign, or that would have made so much of its candidate's warrior past. The American left seems no less convinced that America is a special country. They just have a different view of what makes America special.

Liberals think that America has been defined by its commitment to equality of opportunity (hence their worries about cutting inheritance tax); by its commitment to the separation of church and state (hence their worries about faith-based social policy); and by its enthusiasm for human rights (hence their worries about torture). When liberals created People for the American Way, they did not see it as a covert People for the French Way. The real battle-line in the culture wars is not between pro-Americans and anti-Americans; it is between two groups of patriots who have very different ideas about what makes America America (with the regional battle-lines, incidentally, bearing some similarity to those in the civil war).

This carries a warning for two very different sorts of people. The first is anti-American foreigners: they should not take clowns like Mr Moore or Mr Churchill as typical. Americans are a patriotic

bunch—and, for the most part, this patriotism stretches from one end of the political spectrum to the other. The second is the American right. So far, conservatives have played the unAmerican card extremely well; but when it comes to unAmerican purges there is always a danger of overreach.

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Canada

“Mr Dithers” and his distracting “fiscal cafeteria”

Feb 17th 2005 | OTTAWA
From The Economist print edition

The prime minister will probably survive a sleaze inquiry. Will that allow the old Paul Martin to stand up?

Get article background

AS PRIME-MINISTERIAL occasions go, being questioned for more than four hours at a judicial inquiry—broadcast on live television—hardly ranks among the most agreeable. Indeed no serving Canadian prime minister had suffered such an indignity for 130 years. In the event, Paul Martin acquitted himself rather well when he appeared as a witness before an inquiry into sleaze on February 11th. But 15 months after succeeding his fellow-Liberal, Jean Chrétien, Mr Martin, a successful finance minister for almost a decade until 2002, cannot quite shake off the impression that Canada's top job is too big for him.

As finance minister, Mr Martin acquired a reputation as a tough and decisive deficit-cutter who transformed the public finances and oversaw the renaissance of the Canadian economy. But as prime minister, his faltering leadership has earned him the sobriquet of “Mr Dithers”. At an election last June intended to give him a personal mandate, the Liberals scraped back, reduced to a parliamentary minority. Both before and since, Mr Martin's main concern seems to have been to court popularity by parading a generous social conscience.

Yet before the cameras last week, a steelier Paul Martin resurfaced. He had himself ordered the inquiry—into the siphoning of funds from a C$250m ($200m) federal sponsorship programme set up by Mr Chrétien to promote Canadian unity in French-speaking Quebec. At the time, perhaps the inquiry seemed a clever idea, an attempt both to embrace clean government and embarrass Mr

Chrétien, who had become his bitter rival.

It has turned into a millstone, which has burdened Canadian politics for a year. Judge John Gomery has probed the inner workings of government to find out who—bureaucrats or politicians—oversaw contracts to Liberal-friendly public-relations firms who are said to have skimmed up to C$100m in unwarranted commissions. So far his finds have hardly been earth-shattering: an extravagant C$59,000 for 480 neckties with a Canadian flag ordered by the prime minister's office, for example.

In his own testimony to the inquiry, Mr Chrétien defended the purpose of the scheme—to discourage Quebec from seceding, as it almost did in a referendum in 1995—and hinted that Mr Martin knew more about the details. But the prime minister pleaded his own lofty reasons of state for ignorance. He was immersed in steering the economy and leading the G20, a club of finance ministers, he said. Yes, several of his budgets included a C$50m Canadian “unity reserve” for the prime minister's office which he had never queried. It was up to the Treasury Board, Canada's civil-service department, to monitor this. He said that he did not know the sponsorship program even existed until reading press reports of its mismanagement.

He has probably done enough to distance himself personally from the scandal. But the affair has already damaged his government. Opposition parties made Liberal sleaze the main issue in last year's election. To shift attention, Mr Martin made some lavish spending promises.

Top of the list was a pledge to “fix for a generation” Canada's beloved but creaking Medicare system. The provincial premiers, who run the system, subsequently extracted from Mr Martin a larger cheque than he had originally offered: $41 billion over ten years, as well as a special deal for Quebec. He failed to win any commitments to reform the system in return.

Mr Martin is ceding revenues to the provinces too. On February 14th, he flew to the Maritime provinces to sign a special deal under which Nova Scotia and Newfoundland will keep all their revenues from offshore oil and gas but not lose federal handouts from the equalisation fund (an arrangement under which richer provinces hand over some of their revenues to poorer ones). In doing so, Mr Martin was honouring an unwise election pledge. More federal money is unlikely to revive the Maritimes' economy, which has been slowly dying for decades. But the deal has unleashed a stampede of demands from other provinces, led by Ontario, a Liberal stronghold and the largest of the three net contributors to the equalisation fund.

Last week, a ministerial conference on child care—another of Mr Martin's pledges—again suggested that Quebec should have special arrangements. Mr Martin is setting up a “fiscal cafeteria” for the provinces to choose their own takeaways, quipped Hugh Mackenzie, a Toronto economic consultant. At the same time, the federal government has seemed slow and hesitant in pushing ahead with its own agenda. Mr Martin has travelled abroad almost frenziedly, but a long-promised foreign-policy review has yet to appear.

For now, the prime minister can afford all this largesse. The economy is growing steadily. The federal government has a large fiscal surplus. Yet in allowing his authority to be undermined, Mr Martin may be storing up trouble. This week, the opposition united to defeat a bill to split the Foreign Affairs and International Trade Department into two. A bill to make same-sex marriage legal across the country may barely squeak through in the face of fierce Conservative opposition.

All this means that the budget, on February 23rd, will have unusual political importance. It should allow Mr Martin to set some priorities, rather than responding to those of others. It may include a shake-up of foreign aid, and money for a new rapid-response army brigade. The opposition is unlikely to force a fresh election by rejecting the budget. But if Mr Martin is to win that election when it comes, perhaps next spring, he will have to show more of his decisive leadership of old.

Politics in Brazil

The clergy conspire

Feb 17th 2005 | SÃO PAULO
From The Economist print edition

Lula loses control of Congress

Get article background

IF THE president, Luiz Inácio Lula da Silva, is to push through the reforms needed to sustain a strong economic recovery, this is the year to do it. In 2006 comes an election in which Mr da Silva is all but certain to seek a second term. But this week his government suffered an unexpected defeat which has clouded its legislative prospects and exposed its poor political management.

By tradition, the president of the Chamber of Deputies, a powerful figure who largely determines the agenda of Congress, is chosen from the largest party. On February 15th, that tradition was trashed. The deputies rejected Luiz Eduardo Greenhalgh, the candidate of Lula's Workers' Party (PT). Instead, they chose Severino Cavalcanti, a leader of Congress's rapacious “low clergy”, the unsung backbenchers whose main aim is to funnel pork to their districts.

Mr Cavalcanti is from the conservative Progressive Party, a nominal government ally. But his agenda is not the government's. He wants a near-doubling of congressional salaries to 21,500 *reais* ($8,300) a month, greater congressional independence from the executive branch, fewer measures enacted by decree, which Congress only votes on after the fact, and, most damagingly, greater congressional control over the budget.

The government has only itself to blame for this setback. Mr Greenhalgh was a late and disastrous choice. He is popular with the PT's discontented left wing. That made him distasteful to the governing coalition's more conservative members. But it did not prevent a renegade PT deputy from launching a rival candidacy—a rare breach in the party's normally monolithic discipline.

The underlying problem is that the PT has given too little space in the government to its coalition partners, and paid too little attention to the “low clergy”. That may now change. A cabinet reshuffle by the end of March is expected to bring more faces from outside the PT into government

The government's legislative programme for this year, presented after Mr Cavalcanti's election, is more modest than it might be. It omits autonomy for the central bank, for example, though it includes reform of trade unions and taxes, and broadening access to universities. Getting such measures approved will now be slower, uncertain, and more expensive in pork. There will be an early fight over a government decree that raises taxes. “The situation is not horrible but will be more tiring for government,” says Murillo de Aragão of Arko Advice, a consultancy. That goes for the most important government project of all: preparing Lula for re-election.

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Dorothy Stang

A martyr for the Amazon

Feb 17th 2005 | SÃO PAULO
From The Economist print edition

The land battles behind a murder

Reuters

Get article background

An obstacle to loggers and land grabbers

"DO YOU know what a sobbing monkey sounds like?" Dorothy Stang once demanded of a group of state legislators. She knew, because she had heard monkeys screaming as their habitat was being burnt down. Sister Dorothy, an American nun, had befriended the forest, its wildlife and, especially, poor migrants eking out a living in the Brazilian Amazon. She thus made enemies of loggers and land grabbers, for whom nature and the poor are obstacles. On February 12th she was murdered in Anapu, a district along the Trans-Amazon highway in Pará state where she had worked for 20 years.

Her death has provoked as much shock and grief as the slaying in 1988 of Chico Mendes, who led a struggle by rubber tappers to be able to harvest the forest without destroying it. Yet the Amazon produces an incessant flow of martyrs, most quickly forgotten. Of the 1,349 deaths in land conflicts in Brazil between 1985 and 2003, more than a third were in Pará, according to the Comissão Pastoral da Terra, a group linked to the Catholic Church.

Behind the violence is a toxic mixture: land is cheap but potentially valuable, its ownership uncertain and the state impotent. In Anapu, for example, in the 1970s the then-military government, eager to develop the Amazon, doled out land-use rights. Most did nothing productive, so the government reclaimed the land. In the 1990s Anapu attracted poor migrants, some fleeing land wars in southern Pará. These became Sister Dorothy's flock. She campaigned to obtain land for them and preached that earning a livelihood and conserving the forest could be reconciled.

They were making progress. Some 400 families had settled on land that INCRA, the federal land-reform agency, has earmarked for "sustainable development projects", in which 80% of the land would stay as forest. But the former beneficiaries, or people who thought they had bought the rights from them, continued to covet an area that is flat, stocked with high-value timber and close to a main road. There were at least ten disputes over land ownership in the settlement where two men shot Sister Dorothy.

Stung by accusations that it had ignored death threats against her, the federal government promised to punish the killers (a rare event) and sent 2,000 troops to the area. But that does not

amount to the steady rule of law needed to curb violence and rampant deforestation. Federal and state governments lack both the determination and the resources to supply this. Roberto Smeraldi, of the Brazilian branch of Friends of the Earth, detects “a lot of goodwill” but “very little” action in the two years since Luiz Inácio Lula da Silva became Brazil's president.

The government roused itself late last year, suspending logging licences and demanding that landholders prove their title, an attempt to bring order to the Amazon's Wild-West property market. Loggers and land-grabbers mobilised, blocking a main road and threatening to poison rivers. This month the government retreated, reinstating the licences and lifting the deadline for re-registering property.

But Sister Dorothy's murder may have been, in part, a backlash against progress. Two “extractive reserves” of the sort championed by Chico Mendes were recently created near Anapu, one of them the “largest area of sustainable use on the planet”, says Nilo D'Avila of Greenpeace, an NGO. And land reform is at last taking hold in Anapu. Land-grabbers “were feeling cornered,” thinks Ana Paula Santos Souza of Fundação Viver, Produzir e Preservar, an NGO in Pará. Sister Dorothy's work may yet outlive her.

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The countryside in Latin America

Down on the farm

Feb 17th 2005
From The Economist print edition

Latin America is less urban than is officially thought

IT IS often asserted that Latin America has become the world's most urbanised region. Not so. According to a draft new report from the World Bank*, almost twice as many Latin Americans live in the countryside as official figures suggest. The report also finds that growth in farm output has a disproportionately large impact on the region's economies. So public policies towards rural Latin America matter much. Unfortunately, says the Bank, they are wrong-headed.

When it comes to counting their people, governments in Latin America use many different definitions of what is “rural”, but all tend to treat villages of 2,000 people in remote areas as cities. Under those official definitions, only 24% of Latin Americans (or 125m people) still live in rural areas. But the Organisation for Economic Co-operation and Development (OECD), a rich-country research organisation, applies a more realistic definition of “rural”: it uses it to mean all places that have fewer than 150 inhabitants per square km (0.4 square miles) and are more than an hour's travel from the nearest city of more than 100,000 people. By that definition, according to the Bank, 42% of Latin Americans live in the countryside—though the report's authors stress that the distinction between “rural” and “urban” is a continuum rather than a sharp divide.

Rural areas make an important contribution to the economy. Farming, forestry and fisheries account for a small (12%) and declining share of the region's GDP. But they have important links to other sectors, such as food processors. The Bank reckons that in Latin America a rise in agricultural output of 1% triggers further growth of 0.12% in the non-farm economy the following year. (In rich countries, perversely, bounteous subsidies mean that growth in agriculture is associated with a slight decline in the rest of the economy.)

So the rural economy is worth fostering, especially given that many of the poorest Latin Americans live in the countryside. But public spending in Latin America—when measured against the true size of the rural world—has a bias to urban areas. Policies towards agriculture have too often centred on subsidies to richer farmers and tariff protection. Instead, the Bank wants to see more emphasis on providing public goods—such as education, roads and farm-related research and development—in rural areas.

Some would say that a larger rural population and a very unequal pattern of landholding strengthen the case for land reform. But Guillermo Perry, the Bank's chief economist for Latin America, points out that distributing land alone, unaccompanied by credit and technical help, does little to increase income. The key to reducing rural poverty, he says, lies in improvements to education and roads, to make labour more mobile. Rural families who do get out of poverty normally do not depend on agriculture alone.

The Bank also says Latin America should practise what it preaches on farm trade. Until the 1980s, the region cosseted its industries; now agriculture (especially livestock and food processing) is

more protected than manufacturing. Dismantling protection would lower food prices—though many poorer farmers will need help to adjust. The Bank's research shows that for many Latin American countries, greater access to rich countries' markets is more important than the dismantling of those countries' farm subsidies. But not so for Mercosur (the trade group based on Brazil and Argentina), whose exports face subsidised competition. That suggests that Central America and three Andean countries had some good reasons to seek bilateral trade deals with the United States, while Mercosur was right to desist.

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*"Beyond the City: the Rural Contribution to Development", by David de Ferranti, Guillermo E Perry, Daniel Lederman, William Foster and Alberto Valdés.

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Correction: mining in Peru

Feb 17th 2005
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In our story on mining in Peru ("Halting the rush against gold", February 5th) we stated that Newmont's Yanacocha mine extracts "an ounce of gold from each tonne of rock" it removes. The correct figure is a gram of gold per tonne of rock.

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India and Pakistan

All aboard?

Feb 17th 2005 | LAHORE
From The Economist print edition

It is only a bus, but it gives a tired-looking peace process a burst of life

AT LAST, what looks like a breakthrough in the long quest for peace by India and Pakistan. On February 16th in Islamabad, India's foreign minister, Natwar Singh, and his Pakistani counterpart, Khurshid Kasuri, agreed to “impart momentum” to an ineffably tedious “composite dialogue” started a year ago. But this time there was some substance to the waffle. Most significantly, they agreed to open, from April 7th, a bus route between Srinagar, the capital of Indian-held Kashmir, and Muzaffarabad, the capital of Pakistan-held Kashmir.

The agreement is important in two ways. First, it offers Kashmiris, the real victims of the two nations' squabble over their homeland, something many have longed for. The road linking the two Kashmiri capitals was closed after the first of three wars over Kashmir in 1947-48. Kashmiri families were divided, homes destroyed and centuries-old trade routes blocked. When the reopening of bus links was mooted in late 2003, road signs were swiftly erected in Srinagar, pointing to Muzaffarabad. It was a moment of hope.

Second, the removal of the obstacles delaying this agreement shows a rare flexibility from both sides. Pakistan has always been suspicious of the idea of the bus, fearing that travel between the two Kashmirs would legitimise the existing “line of control” that divides them, turning it into a permanent border. Wanting precisely that, India had insisted on those using the bus carrying national passports, thereby conceding its sovereignty over at least part of Kashmir. Now it has agreed that, once identities have been verified, in some unspecified way, passports will not be needed.

Optimists believe that the opening of the roads linking the two halves of Kashmir could be the bond that keeps the peace. It ought to restore dignity to the shattered lives of Kashmiris on both

sides and give them a real stake in peace rather than in insurgency and *jihad*. Kashmiris on either side of the divide will be able to embrace each other in only three hours.

More generally, the reopening of transport links means the restoration of age-old trading routes in the subcontinent. It takes nearly eight hours by road from Amritsar in Indian Punjab to Jammu, the closest point in Indian Kashmir. But it would take half as long if a traveller could transit Pakistan. The hinterland of Lahore, capital of Pakistani Punjab, used to stretch from Delhi to Srinagar. It might do so once more.

The foreign ministers reached other, less contentious, agreements as well. The two countries will open rail links further south, between Pakistan's Sindh and India's Rajasthan states. They also decided on a joint push for oil and gas pipelines through Pakistan to India: from Turkmenistan, through Afghanistan; and from Iran and Qatar. India is short of energy and Pakistan stands to benefit from hundreds of millions of dollars in transit fees.

All of this suggests that the peace process launched by India's former prime minister, Atal Behari Vajpayee, in April 2003, is back on track. Ever since his party lost an election last May, there have been fears that the momentum had been lost. Indian foreign policy under the new government, led by the Congress party, had seemed to be back in the hands of crusty diplomats, schooled in Pakistan-bashing. But the patience of Pakistan's president, Pervez Musharraf, has been vindicated. At last he has something to show for the olive branches he has thrown at India, notably a ceasefire along the line of control in November 2003, and an effort to rein in the Pakistan-based militants stoking the insurgency in Indian-controlled Kashmir.

They could yet upset this process through a spectacular act of terror in Kashmir or in India. Hardline separatists in Indian Kashmir have been swift to reject the bus deal as a sop that avoids the real issue of the territory's status. They will not stop fighting yet. The Indian army, too, may find it hard. It has this month promised to adopt a friendlier approach in Kashmir, and, after a brutal war that has claimed perhaps 60,000 lives, to try to win hearts and minds. But India may not be able to stomach close political links between Kashmiri separatists in Srinagar and their brethren in Muzaffarabad.

There are also bound to be security-related snags over the pipeline projects. It will take some time before Afghanistan is stable enough to carry the pipeline from Turkmenistan. And Pakistan's army is gearing up in Baluchistan to combat a nationalist insurgency that is threatening existing pipelines. Disagreements over another crucial resource—water—could also sour relation between the two rivals.

Or the two countries could simply succumb to the weight of history and start squabbling again. But this week's breakthrough implies two very hopeful things: that the national-security establishments in both are now ready to recognise the pivotal role of economics in bilateral relations. And second, that resolution of the Kashmir dispute is no longer a precondition to better relations. Rather, it is seen as a potential consequence.

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China and North Korea

Managing chaos

Feb 17th 2005 | BEIJING
From The Economist print edition

Can China help to curb North Korea's nuclear ambitions?

Get article background

WHETHER North Korea possesses a nuclear bomb—as it claimed on February 10th, when it said it would no longer take part in the six-country talks about its worrying nuclear programme—the rest of the world has yet to establish. The country's government has a habit of lying, especially when the stakes are high. But there was no doubting the sincerity of the response from China, which was hosting the negotiation. It has reiterated its desire for a nuclear-free Korean peninsula, and urged North Korea to return to the negotiating table. How much influence over its stubborn neighbour can China hope to wield?

More than any other country, seems to be the view of America, Russia, Japan and South Korea—the other participants in the process. As an historical ally of North Korea, and its main supplier of food and energy aid, China has the ear of the country's leader, Kim Jong Il. Its influence is strengthened by America's refusal to talk to the North on its own.

China has an obvious interest in getting the six-way talks back on track. The more indebted America feels, the less likely it is to be tough on other prickly subjects—like China's claim to Taiwan or its dodgy record on human rights. It has reasons of its own to fear the prospect of a famished and corrupt neighbour brandishing nuclear arms. In such an eventuality, China's other neighbours might take unwelcome steps too, like going nuclear themselves—or at least ratcheting up their defence spending.

Too hard, too soft

If China's diplomacy is in earnest, however, it has yet to achieve a result—as the North's latest fit of defiance demonstrates. Shi Yinhong, a professor of international relations at the People's University in Beijing, says that the Chinese have long been frustrated by an American approach to North Korea which they consider too hawkish. But, he says, China must recognise that its own line has been too soft. He predicts that China may issue a harsh warning to North Korea, and perhaps apply economic pressure as well. On February 17th, China said that a senior communist party official would be dispatched to Pyongyang to discuss the issue.

The authorities in China have already used the state-run media to send a few subtle signals of annoyance. Publications that have been in the habit of stressing the historical friendship between China and North Korea were abruptly cooler and less sympathetic in their reporting of last week's rumpus. And while government censors usually scrub online message boards of any content deemed sensitive, many anti-Pyongyang rants have been posted on the internet and left to stand.

All this was in sharp contrast to the recent fate of a long-established Chinese academic journal, *Strategy and Management*. Last year, it was forced to recall an issue containing a highly critical article about North Korea. The piece accused Pyongyang of being ungrateful to China for its help over the decades, of ignoring the needs of its hungry people, and of complicating China's international affairs. This was tactless. Not long afterwards, a complaint from North Korea forced the offending issue to be recalled. Then the journal was closed down.

Even if it now clings to a somewhat firmer line, China will continue to approach its unpredictable neighbour with a certain delicacy. Robert Ross, an expert on Chinese security issues at Boston College, says that China is always careful to calibrate its aid supplies to North Korea in order to steer a middle path between two undesirable outcomes: a total collapse that would spill refugees across the border, and a resurgence that might spur the regime on to even crankier policies. China's strategy seems to be to guide the North into a peaceful and gentle collapse. That may be a prudent policy, but it is one that puts a strict limit on China's leverage.

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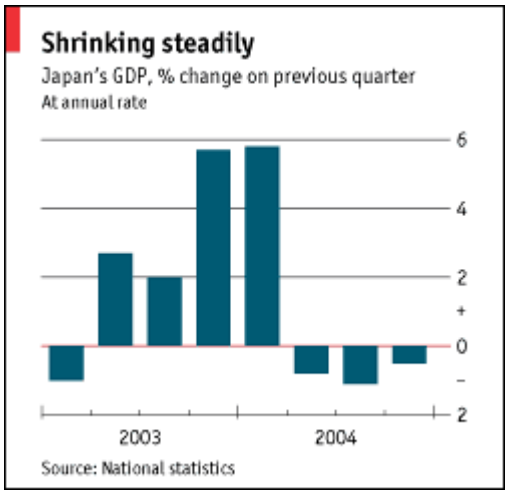
Japan's economy

Only a recession

Feb 17th 2005 | TOKYO
From The Economist print edition

The latest data may exaggerate the economy's feebleness

Get article background



THE figures may be muddled, but the "R" word can always be counted on to grab headlines. Japan's latest GDP numbers, released on February 16th, suggest that the country's economy has technically been in "recession" since last spring. This belated announcement reflects sharp downward revisions to figures for the second and third quarters of last year, during which real GDP now appears to have fallen at annual rates of 0.8% and 1.1% respectively. Preliminary figures for the fourth quarter hint that the economy was still contracting late last year, with real GDP falling a further 0.5% at an annual rate. Is Japan slipping back into the malaise that engulfed it during the 1990s?

Recessions make arresting headlines, but the word seems a trifle gloomy in this case. Japan's GDP figures are notoriously flawed: analysts in Tokyo have lately been treating them as though they were picked from a hat. And although the economy clearly lost much of its momentum during the course of last year, there are also signs that it may be picking up again.

Consumers have been the biggest spoilers of late. Private consumption fell at a 1.3% annual rate in the fourth quarter. Some of this appears to reflect temporary factors, however, including an unusually severe series of typhoons. There are hints that consumption has begun bouncing back a bit. Wages have also risen, and house prices show signs of having hit bottom. Much will depend on whether these trends continue, boosting consumer confidence.

Japanese companies, at least, remain bullish. Their earnings over the past few years have grown impressively, with profits rising strongly in the second and third quarters of 2004, even as the government's GDP figures fell. This has helped reduce bankruptcies, which in January declined for the 25th month on the trot. Japan's big banks also look healthier, now that fewer of their borrowers are in a parlous condition. The government is closing in on its target of cutting the banks' bad-loan ratios to 4% of all loans by the end of March—a goal that looked dreamy when Heizo Takenaka, the economic-policy chief in Junichiro Koizumi's cabinet, announced it in late 2002. Those higher profits have also helped to drive construction of new plants, as well as investment in machinery and other capital equipment at home and in neighbouring China.

Japan's exposure to China's economy—which surpassed America as its biggest trading partner last year—is often overstated. Many of Japan's exports of machinery and electronics components have been driven by Japanese companies setting up shop in China, and then exporting their products

around the world. So if China's domestic economy slows, Japanese exports might be buoyed by strong growth in America and elsewhere.

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Terrorism in the Philippines

New Abu Sayyaf

Feb 17th 2005 | MANILA
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The government's old foe gets into bombing

Reuters

Anyone at home?

THREE bombs ripped through three cities in the Philippines on February 14th, sparking a familiar series of claims and counter-claims. Responsibility for the blasts was claimed by the Abu Sayyaf, an Islamic terrorist organisation. Gloria Arroyo, the country's president, vowed to “wipe out” the group—a vow she had made several times in recent years, evidently in vain.

The explosions, in the southern cities of Davao and General Santos and in the Makati financial district of Manila, killed at least 12 people. A spokesman for the Abu Sayyaf described them as a “Valentine's-Day gift to Mrs Arroyo”, in retaliation for the government's “atrocities committed against Muslims”. If so, the group is getting into quite a new line of business. The Abu Sayyaf, which may be able to muster only a few dozen members, has been accused by the government and its American ally of having links with al-Qaeda. Yet its motivation would appear to be less lofty than that of Osama bin Laden's paradise-seekers. For years, its main occupation has been kidnapping foreign tourists and Christian businessmen for ransom. Why would it take up bombing as a matter of principle?

One theory is that the bombs were meant to win the Abu Sayyaf credit with a different lot of Muslim militiamen who have been battling security forces on the south-western island of Sulu since February 7th. They are believed to be renegade members of yet another Muslim separatist group—the Moro National Liberation Front—which made peace with the government in 1996 after a decades-long campaign. The ongoing violence has cost the lives of 25 soldiers and between 70 and 100 militants, according to the army, and driven 22,000 people from their homes.

The Abu Sayyaf had been fairly quiet since last February, when it detonated a bomb on a passenger ferry belonging to a shipping line from which it was trying to extort money. The bomb started a fire that wrecked the ship, killing over 100 people. But it does seem logical that it should stir itself for the militiamen, in whose unruly area it is known to find shelter. The latest fighting began after government troops killed four people, three of whom they claimed were members of the Abu Sayyaf. Protesting that the other victim was a child, and that in fact none belonged to the Abu Sayyaf, the local militiamen retaliated by attacking several army outposts. The army countered with helicopter gunships and artillery.

No doubt the militiamen will be badly bloodied. In counter-terrorism, however, such weapons can

be blunt tools. Having arrested several suspects in the bombing of the ship, the government claimed to be close to eradicating the Abu Sayyaf. But this appears not to be the case: the group's leaders remain at large, to plot future kidnappings and bombings. While warlordism and violence reign in Sulu, and other wild, mostly Muslim refuges in the south, they may stay at large for some time to come.

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Kazakhstan

Capital suggestion

Feb 17th 2005 | ALMATY
From The Economist print edition

Visitors to Kazakhstan will be unable to fly direct to the main city

Get article background

AT THE inauguration of a gleaming passenger terminal at Astana airport this month, Nursultan Nazarbaev, Kazakhstan's president, expressed the hope that the airport would become a major transit point between Europe and East Asia for the world's great airlines. Fat chance: these days, airliners have no need to stop over midway. Moreover, the few international airlines that do land in Kazakhstan—such as British Airways, KLM and Lufthansa—prefer to land in Almaty, the country's former capital and biggest city.

This does not please Mr Nazarbaev. His pet project has been to transform Astana from a drab Soviet-style city, a lump of concrete in a wilderness of empty steppe, into the nation's administrative centre. In 1997, he moved the government from Almaty to Astana. The city's population has since increased from 300,000 to over 500,000. In 2004, $1 billion was spent on construction, creating a clanking of cranes day and night.

And yet no one seems to like the place, neither locals nor foreigners. It is located in the northern steppe, notorious for its harsh climate: daytime temperatures recently dropped to -25 degrees Celsius, and were made to seem even colder by a constant cruel wind. The authoritarian Mr Nazarbaev frequently scolds members of his cabinet for spending too many weekends in Almaty, in the mountainous and more pleasant south.

But the president's patience has run thin. The civil-aviation commission recently informed international airlines operating in Kazakhstan that from this autumn they will not be permitted to fly to Almaty. The immediate beneficiary of this change will be Air Astana, a Kazakh-British joint-venture, that has a monopoly on the route between Astana and Almaty.

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Cambodia

Rotten at the core

Feb 17th 2005 | PHNOM PENH
From The Economist print edition

Graft is slowing Cambodia's return to better health

AFP

Treat yourselves

“WE ARE on a declining trend,” Sok Hach, a Cambodian economist, gloomily declares. Economic growth, he predicts, will slump to perhaps 3.5% this year from 7% last year. The proportion of Cambodians living in poverty—some two-thirds of them on less than $2 a day, and almost half on less than $1—is not falling. Infant mortality has actually risen since 1991, when United Nations peacekeepers arrived to help snuff out Cambodia's decades-long civil war and supervise democratic elections. Nor does Cambodia's democracy look very robust: Sam Rainsy, the leader of the opposition, has fled the country after parliament stripped him of his immunity from prosecution. Hun Sen, the prime minister of 20 years, recently announced that he would have to stay on indefinitely, for the good of the country. How can Cambodia have so little to show for over a decade of reconstruction and development, costing roughly $400m a year in international aid?

The answer—as in so many multilaterally rebuilt places—is bad governance. The current administration, an uneasy coalition of socialists and royalists, seems to have few strong feelings about how Cambodia should be developed. Mr Hun Sen, in particular, is more a survivor than a visionary. When it comes to economic policy, he tends to follow the suggestions of the donors who fund his budget, but with little zeal. Mu Sochua, a former minister who recently defected from the government to the opposition, says that her erstwhile colleagues are interested only in preserving and extending their authority.

Addressing a conference in Cambodia earlier this month, James Wolfensohn, the president of the World Bank, said the government's top three priorities should be “fighting corruption, fighting corruption and fighting corruption.” The bank recently uncovered a procurement scam at one of its local projects, and suspects it may find more. It has brought in a special auditing team to investigate. Local businessmen say that payoffs add 15% to the cost of doing business in

Cambodia. Jobs in the civil service, candidatures for political parties and even ministries are said to go the highest bidder.

The government claims to be cleaning up its act, but has little to show for it. Despite years of talk, a draft anti-corruption law remains on the drawing board. No senior official has ever been jailed for embezzlement or abuse of office. If anything, it is whistleblowers who are at risk. Parliament lifted Mr Sam Rainsy's immunity, after all, so that Mr Hun Sen and other grandees could pursue libel cases against him.

Voters tolerate this mess in part because their expectations are so low. From 1970 to 1990, Cambodia was more or less permanently consumed by civil war. But there has been no fighting since a brief flare-up in 1997. The current coalition, in place since 1993, has not only restored stability, it has also built some schools and resurfaced the odd road—a stellar record by the standard of past governments.

The media and pressure groups have higher standards, but little influence. Some 80% of Cambodians live in the countryside, and what little news they get tends to come from the television, which the government controls. Every now and again, an outspoken radio host, union leader or activist is shot dead by mysterious assassins. Indeed, some see progress in the government's decision to pursue its current crackdown on the opposition through the courts, and not by cruder means.

A lack of capable and educated officials exacerbates these problems. The radical leftists of the Khmers Rouges, who ran the country for four years in the late 1970s, exterminated roughly a quarter of the population, including almost everyone with more money or education than the norm. So the country now has few accountants or auditors, for example. Only one judge in six has a law degree, including only one of the nine on the Supreme Court. Paltry salaries—as little as $20 a month—push most civil servants to corruption.

Cambodia's foreign benefactors also bear some of the blame. Last year, a World Bank report faulted donors for failing to tie handouts to results. They have also spent too much money on hiring expensive foreign consultants to concoct development schemes, the report argued, and not enough on teaching Cambodians how to implement them. It costs as much to keep 800-odd foreign advisers in the country, the Bank estimates, as it does to run Cambodia's entire civil service. What's more, donors have neglected agriculture, the livelihood of most Cambodians.

But there are inklings of change. Some donors, at least, seem to be getting tougher. Both the World Bank and the World Food Programme, for example, have recently demanded that the government pay back grants wasted through corruption. Cambodia's normally quiescent farmers, for their part, are beginning to protest at corrupt land grabs.

But the strongest pressure is economic. The garment industry employs over 200,000 people, and accounts for 80% of the country's exports. Yet, since the abolition of the international system of quotas for garment exports at the beginning of the year, Cambodian firms face fierce competition from rival exporters such as China. The projected slump in economic growth this year stems entirely from the poor prospects of the industry. As one foreign observer notes, if the prospect of losing the country's only flourishing industry does not put the fear of God into the government, nothing will.

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Lebanon

Death of a statesman

Feb 17th 2005 | BEIRUT
From The Economist print edition

AP

After Rafik Hariri's assassination, what will happen to the country he rebuilt?

THE massive explosion that killed Rafik Hariri and 16 others cast an instant, stunned silence across Lebanon. Not since the 1975-90 civil war had Beirut seen such a blast, shattering windows a mile away and scooping a crater ten feet deep and 30 feet wide. The mourning for the former prime minister, which brought out the biggest crowds the country had ever seen, quickly became as much a show of national protest and unity as of grief.

Mr Hariri was, in many ways, the central pillar of post-war Lebanon. Not only did he serve as prime minister for ten of the past 12 years; he invested his charm and cunning, as well as the vast fortune he had made as a contractor in Saudi Arabia, into rebuilding his shattered homeland. Virtually all that is shiny and new in Lebanon, and there is much of it, owes its existence to Mr Hariri.

He was equally crucial to the country's political reconstruction. Personally untarnished by the war, he paid with his own money to gather its battered veteran politicians at the Saudi city of Taif, in 1989, to hammer out a deal to disband militias and distribute power more equitably. Despite accusations of corruption, profligacy and favouritism towards his own Sunni Muslim sect, Mr Hariri subsequently managed to balance competing interests well enough to allow a return to relative calm and prosperity.

He made enemies along the way. Many accused him of allowing Syria, whose troops and spies underpinned the peace, to tighten its hold over Lebanon. But Mr Hariri's wealth and powerful friends, such as France's Jacques Chirac, allowed him a certain independence from Syria.

Recently, his ties to Damascus looked strained. Last September, shortly after the UN Security Council voted to demand Syria's withdrawal from Lebanon, Syria and its local allies moved to extend the mandate of Lebanon's weak, garishly pro-Syrian president, Emile Lahoud. Mr Hariri resigned as prime minister. Although still keen to maintain a balancing role, he found himself drawn towards Syria's opponents. With parliamentary elections scheduled for May, the possibility of Mr Hariri throwing his weight behind the opposition emerged as a threat to Syria's ambition to retain its slipping grip.

Street opinion in Beirut blames Syria for his death. And while refraining from a direct accusation, America recalled its ambassador from Damascus for urgent “consultations”. Predictably, Syria blamed Israel for the assassination.

Popular anger against Syria and its stooges has reinvigorated Lebanon's opposition. An emerging alliance of former foes from across the sectarian spectrum has taken the tragedy as an opportunity to push its agenda. Some, such as the Druze chieftain, Walid Jumblatt, now openly demand that Syria end its 27-year presence. Others have called for the resignation of Lebanon's own government. The normally quiescent Maronite church, Lebanon's largest, explicitly charged what it called Lebanon's “dictatorial regime” with responsibility for Mr Hariri's murder.

Hassan Nasrallah, leader of the Shia party-cum-militia Hizbullah (a key Syrian ally), respectfully describes the slain prime minister as having been the only solid bridge between the opposition and Syria.

What will happen now that he is gone? One possibility is that Mr Hariri's murder represents the opening shot in a violent showdown. Syria and its allies may grow less subtle in their efforts to cow their opponents. Asked what he expects to see next, Mr Jumblatt says: “More car bombs”.

Lebanese factions have neither the will nor the weaponry to fight. What they have are fresh memories of the grief the last war brought

What unites Syria's allies is not simply that they have profited from Syria's presence. They also share historical resentment at the traditional sway held by the very groups coalescing against them, which now include Mr Hariri's Sunnis in addition to Druze and Maronites. Perhaps more importantly, they also fear that Lebanon's opposition represents a spearhead for American and Israeli influence. This, of course, is a view shared by Syria's sole regional ally, Iran, which offered Syria its unflinching support this week.

A rosier scenario would see Lebanon's tensions eased by negotiation, ending in clean elections, and perhaps a referendum on Syrian withdrawal. Few Lebanese regard a third scenario, the eruption of renewed civil war, as likely.

Today, Lebanese factions have neither the will nor the weaponry to fight. What they have are fresh memories of the grief the last war brought, and a hunger for peaceful change. There is a widespread feeling, in Lebanon and much of the Middle East, that the price of maintaining the status quo is mediocrity and strife, whereas the reward for relinquishing old obsessions may be prosperity, and perhaps even an open and just society.

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Iraq's election results

Shia delight and Sunni gloom

Feb 17th 2005 | BAGHDAD
From The Economist print edition

After a successful poll, victorious Shias are reaching out to Sunni Arabs

Get article background

TWO weeks ago, few of the policemen on the firing range in Saddam Hussein's former palace complex in Tikrit could hit the target even once with 20 shots. Now, after a burst of American training, many are scoring 20/20. Since the policemen are Sunni Arabs, many of them veterans of Saddam's army, this might sound like evidence that some members of Iraq's most turbulent minority are coming to terms with the new order. Yet none of the policemen admits to having voted in the election on January 30th.

With most votes counted, it is clear that the 80-year exclusion from power of Iraq's Shia majority is well and truly over. Provisional results gave 51% of the vote to the United Iraqi Alliance, a multi-party, Shia-dominated group. The "clerics' list", as it is known, looks likely to produce the next prime minister. After much back-room haggling, the leading contender has turned out to be Ibrahim al-Jaafari, head of the Dawa party, an Islamist group that trumpets its local roots (see article).

Shias and Kurds up, Sunnis down
Iraq's election result, projected

Party/list	Number of votes	Seats won
United Iraqi Alliance	4,075,295	140
Kurdistan Alliance	2,175,551	75
The Iraqi List	1,168,943	40
Iraqis	150,680	5
Alliance of the Turkomen Front of Iraq	93,480	3
Independent Nationalist Cadres and Elites	69,938	3
Islamic Kurdish Society	60,592	2
Islamic Labour Movement in Iraq	43,205	2
Union of the People	69,920	2
National Assyrian Alliance	36,255	1
National Democratic Alliance	36,795	1
Reconciliation and Liberation	30,796	1
Total	8,011,450	275

Source: Iraqi Prospect Organisation

Picking a prime minister requires a two-thirds majority, however, so the clerics' list will need both to remain cohesive and to make deals with other groups. For example, the second-placed Kurdistan Alliance, which won 26% of the vote and swept the northern provinces, might back the clerics' list in return for concessions on Kirkuk, a key oil town. The Kurds want Kirkuk to fall under an autonomous Kurdistan regional government. They are also angling for the largely ceremonial presidency to be awarded to a Kurd, Jalal Talabani.

In third place, with 14.5% of the vote, was the secular "Iraqi" list, led by the current prime minister, Iyad Allawi. Fourth was a list led by the current president, Ghazi al-Yawer, a Sunni Arab, which should pick up no more than five seats in the 275-member National Assembly.

Sunni Arabs, who are a fifth of the population and have dominated Iraq for generations, are under-represented in the new parliament because so few of them voted. Turnout in Sunni provinces ranged from around 29% in Salaheddin to barely 2% in Anbar, as the influential (Sunni) Muslim Scholars' Board called for a boycott and terrorists threatened to kill anyone who cast a ballot.

The Muslim Scholars' Board calls the new government “illegitimate”, but such views may be losing influence. Many Sunnis are realising what their failure to vote could cost them. More Sunni politicians are speaking of the board's “destructive influence”. Some say they hope more Sunnis will vote in the next round of elections, expected later this year.

The victors, meanwhile, are anxious to bring Sunni Arabs into the system, particularly on to the committees charged with drafting a new constitution. Many Sunni politicians seem happy to oblige.

The Sunni boycott may cause the worst distortions at a provincial level. Freshly elected provincial councils have considerable power to disburse development funds and patronage. Thanks largely to the board, the ones in Mosul and the disputed city of Kirkuk will be dominated by Kurds, which may drive Sunni Arabs in those areas into the arms of the insurgents.

Now that Iraqis control their own government, the priority for America (and other members of the occupying coalition) is to beef up the Iraqi security forces. Gone is last year's talk about the need to crush the insurgency before foreign troops can withdraw from Iraq. That task, the Americans now say, is for Iraqis. Major-General Joseph Taluto, commander of America's newly arrived 42nd Infantry Division in north-central Iraq, says he expects to scale back operations in urban areas substantially by the end of this year, and to see Iraqi forces weaned from joint patrols on to fully autonomous operations.

The Sunni policemen in Tikrit see things differently, however. Better assault rifles are helpful; give us more of these, they say, and we can defeat the insurgents now. One lieutenant says his task would be easier without the Americans, as their presence goads many young men to rebel.

By demonstrating that Iraqis can take control of their own country by peaceful means, the election may have weakened the insurgency. American officials seem eager to play up the widening gap—real or imagined—between irredeemable terrorists (such as the Jordanian al-Qaeda leader, Abu Musab al-Zarqawi) and potentially more reasonable “Sunni rejectionists”. But there is still a chance that the trainees on the firing range will go on to “fight for the highest bidder”, as one of their supervisors puts it. Most appear content with their starting wage of 240,000 dinars ($170) a month. But in the long term, Iraq's new government will have to work hard to secure their loyalty.

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Iraq's probable new premier

The voters call a doctor

Feb 17th 2005 | BAGHDAD
From The Economist print edition

Ibrahim al-Jaafari will have to be tougher than he looks if he is to govern Iraq

Get article background

AP

The new man in the hot seat

A FORMER physician with a scholarly manner, Ibrahim al-Jaafari is not the kind of leader Iraqis are used to. The current prime minister, Iyad Allawi, likes to rev up his soldiers' spirits by wading among them and urging them to send terrorists to hell. It is hard to imagine Mr Jaafari doing that. Yet the soft-spoken vice-president has emerged as the preferred prime-ministerial candidate of the two main parties of the United Iraqi Alliance (the "clerics' list"), a Shia-led coalition that has been allocated 140 of the 275 seats in Iraq's next parliament. Others still have their hats in the ring, but Mr Jaafari is the favourite to become Iraq's first elected prime minister.

Mr Jaafari heads the Dawa party, one of the two big ones that make up the clerics' list. When the provisional election results were first announced, and it appeared that the other party, the Supreme Council for Islamic Revolution in Iraq (SCIRI) had done better, many assumed that its leader, Adel Abd al-Mahdi, would get the top job.

That would have rattled secular Iraqis and Sunnis. SCIRI's success stems from its close association with the Shia clergy, and despite its repeated insistence that it no longer wants an Islamic republic, not everyone is convinced. SCIRI sided with Iran during the Iran-Iraq war of 1980-88, and many Iraqis still consider it a pawn of Tehran. So there was relief, in some quarters, when Mr Abd al-Mahdi withdrew his candidacy.

Dawa activists had argued that Mr Jaafari would be a less divisive prime minister. Although Mr Jaafari lived in both Tehran and London during the 1980s and 1990s, his party was active underground in Iraq throughout the Saddam era. Dawa is known as the party of the "suits" rather than the "turbans": though it favours Islam as the state religion, many of its activists also argue that clerics should stay out of politics.

Opinion polls consistently rank Mr Jaafari as one of Iraq's most popular politicians. But will he be a good prime minister? Not even his allies think him charismatic. And some Iraqis worry about what Dawa may have offered SCIRI in return for Mr Abd al-Mahdi's withdrawal. The turbans are thought to be eyeing the interior and defence ministries, perhaps in order to pack them with members of their "Badr Corps" militia. That could alienate a lot of Iraqis.

Israeli settlers in Gaza

A poll about the pull-out

Feb 17th 2005 | JERUSALEM
From The Economist print edition

Would a referendum make it easier?

Get article background

IT SEEMS a no-brainer. Later this year Ariel Sharon plans to evacuate the 8,000-odd Israelis in the Gaza Strip from their settlements and pull out the army. His opponents, most of whom wish to preserve Israel's grip on every inch of land, say the prime minister should call a referendum. Polls show that over two-thirds of voters support the Gaza withdrawal, and also that over 60% favour a referendum. So why not hold one and have done with it?

The pressure on Mr Sharon to do just that is growing, not only from his opponents, but also from supporters who fear that the issue could otherwise cleave the nation. Protests that began small have mushroomed. Last month, some 150,000 people demonstrated outside the Knesset.

The army, already trying to staunch the losses from doveish conscientious objectors, now has to deal with hawkish ones. Rabbis have urged soldiers not to evict fellow Jews. Last month, six officers who had publicly refused to take part in the evacuations were dismissed. Settlers talk of mass resistance; even civil war.

A small but fanatical core, meanwhile, is targeting politicians. Its tactics range from the mildly amusing (a salad in the face for Binyamin Netanyahu, the finance minister) to the thoroughly unfunny (letters threatening rape and murder). These have had their effect. This week the security minister, Gideon Ezra, suggested applying “administrative detention”, ie, long spells in jail without trial, to keep the extremists out of action.

A referendum would legitimise the withdrawal plan and isolate its opponents. And yet Mr Sharon has rejected the idea. Why? Rightists say he secretly knows a plebiscite would fail. Leftists believe that he wants the Gaza withdrawal to be as traumatic and divisive as possible; they point to a newspaper interview last autumn in which Dov Weisglass, one of Mr Sharon's aides, said that the point of the Gaza pull-out was to preclude or delay indefinitely giving up any of the West Bank.

But that interview was given when Yasser Arafat was still alive and there were no prospects for peace talks between Israel and the Palestinians. Today Mr Sharon's stated reason for not holding a referendum is at least as plausible: that it would take too long. Israel has no referendum law. Opponents of the pull-out could easily use the drafting of such a law to delay the plan for months and perhaps sink it.

In any case, Mr Sharon calls the shots, for most of the Knesset's members oppose a referendum too. Now that the Knesset has passed a law (this week) to compensate evacuated settlers, all further phases of the pull-out need only to be approved by the cabinet. The question, therefore, is what Mr Sharon can do to defuse public opposition to the withdrawal.

To some extent it has already defused itself. The settlers' use of orange-star badges—reminiscent of the Nazis' yellow stars—appalled many Jews. The crudeness of the extremists' threats is not helping them either. Mr Sharon has been playing them up: this week he announced that he would hire a security firm to protect his wife's grave from desecration. And the compensation law contained a sweetener: 43% more money than originally planned.

All the same, the protests will not end soon. A third of the Knesset members from Mr Sharon's own party, the Likud, oppose the withdrawal, and are threatening to block his budget. If this is not passed by March 31st, Mr Sharon will have to call an election. The only way out will be some artful rejuggling of his already unwieldy coalition government.

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South Africa's economy

Mbeki's colour scheme

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Good and bad ideas for making black South Africans richer

Get article background

IN HIS “state of the nation” speech last week, Thabo Mbeki, South Africa's president, set himself the goal of spurring faster economic growth and, simultaneously, a quicker transfer of wealth from white to black pockets. The growth, he hopes, will come from extra state spending, less restrictive labour laws, simpler taxes, less bureaucracy and more competition. For the redistribution, he is relying on a baffling array of “industry charters” and official plans known collectively as “black empowerment”. The trouble is, his two strategies conflict: the first aims to reduce the cost of doing business, the second risks lifting it up again.

First, the good news. A decade of fiscal caution has given South Africa's government leeway to splash out. Since June last year, 76,000 public-works jobs have been created and 11,000 new police have been recruited. Some 180 billion rand ($30 billion) will be laid out on the country's rusting train network, cramped ports, spluttering power grid and other state-run things in the next few years. Better credit ratings and a more stable currency have drawn more private money into South Africa, too. BusinessMap, a consultancy, says last year saw a record $5.8 billion inflow; for this January alone it has counted another $8 billion (promised, not yet delivered).

The government's advisers have identified 140 regulations that suffocate small businesses. Mr Mbeki won't cut all of them, but he said he wanted rules that let big firms set wages for a whole industry in centralised salary negotiations scrapped for small companies. Small firms are also to be exempted from many ad hoc taxes, such as the ill-managed “skills levy”, an unpopular tax on jobs. And a contorted corporate-tax system is also to be made simpler, for all firms, by next April.

Some of this is controversial. Mr Mbeki's trades-union allies howled at the notion of labour-law reform. Firms not quite small enough to win the new exemptions will also be miffed.

But the biggest controversy concerns “black empowerment”. Foreign investment in mining slumped last year, partly because miners were unsure exactly how the government was planning to transfer dollops of the industry into black hands. Last week, a land-ministry official said the nationality and race of all landowners might be recorded on title deeds. Besides its echoes of the race-obsessed apartheid era, this idea spooks non-black investors, and not only those who fear that a future populist government might do a Mugabe.

The government argues that racial “transformation” will come too slowly if it does not force the pace. Most good farm land remains white-owned. A black middle class is fast emerging, but barely 4% of the Johannesburg stock exchange is black-owned, half its peak in 1998. Yes, retort Mr Mbeki's critics, but the slump in black share ownership occurred because too many white firms were pressured to sell chunks of their businesses to well-connected blacks, under whose

inexperienced stewardship share prices plunged.

The most useful leg-up the government can provide for black South Africans may be to promote economic growth, rather than trying so hard to determine who enjoys its fruits. The pro-business reforms Mr Mbeki proposed last week are a start. And if they help white businesses as well as black, that would be no bad thing.

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Somalia

Yusuf the uniter?

Feb 17th 2005 | MOGADISHU AND NAIROBI
From The Economist print edition

Somalia's exiled president has plans to end his homeland's anarchy

AFP

Off to work in Mogadishu

Get article background

NEXT week, Somalia's exiled government is due to return home. At least, that was the optimistic timetable its new president, Abdullah Yusuf, drew up earlier this month. The trouble is, Mr Yusuf has no army, no budget and no guarantee that he won't be shot as soon as he sets foot in the capital, Mogadishu. Even one of his ministers is calling for war.

Somalia is not an easy place to govern. It fell apart in 1991, when several tribal militias clubbed together to remove a dictator, Mohamed Siad Barre, and then turned on each other. Since then, the country has been ruled by warlords, whose sparring has cost perhaps half a million lives and driven over 750,000 people from their homes. Thirteen attempts to restore order, mostly backed by rich-country donors, have failed. The fourteenth is now reaching a crunch point.

Mr Yusuf heads a transitional Somali government, created with EU cash in neighbouring Kenya last year. Unlike some previous attempts at nation-building, this one includes most of the people who matter in Somalia—ie, the warlords—as well as elders, local politicians and people who work for non-governmental organisations.

When and if the transitional government tries to go home, Mr Yusuf thinks, it will need foreign protection. He has asked the African Union to send 15,000 peacekeepers to help him. He will be lucky to get half that. Mr Yusuf says he “cannot function” without foreign military back-up, which is probably true, but the peacekeepers could themselves create problems.

One of the five African nations offering to send troops is Ethiopia, a neighbour with a long history

of fomenting discord in Somalia. The International Crisis Group, a think-tank, warned that the arrival of foreign troops, especially Ethiopians, might rekindle Somalia's civil war. On February 14th, thousands of people gathered in Mogadishu to protest against what many saw as a looming foreign invasion. Even Mr Yusuf's government is divided over whether Somalia needs peacekeepers. His housing minister has urged Somalis to take up arms against them.

The atmosphere in Mogadishu is agitated and xenophobic. A Muslim cleric has reportedly issued a fatwa against foreigners, and there are rumours of a $5,000 reward for anyone who kills one. Last week, a BBC producer was assassinated outside her hotel in Mogadishu, and a government delegation was shot at. This week, a bomb apparently aimed at visiting African Union envoys killed a bystander.

The precedent for peacekeeping in Somalia is grim. In 1992, America dispatched troops to protect famine-relief workers, and ended up embroiled in local factional warfare. After a bitter night of fighting in 1993, in which 18 American soldiers and around 1,000 Somalis were killed, American troops pulled out.

The new Somali government faces an extraordinary challenge, to secure a lawless country with minimal foreign military or financial assistance. In timing its return to Mogadishu, Mr Yusuf is caught between the inflexible timetables that foreign donors often demand and the depressingly flexible record of African armies for delivering what they have promised. On top of this, he must placate those warlords who remain outside his government, and the government of Kenya, which has grown fed up with hosting so many Somali politicians.

Mr Yusuf's recent performance has not been encouraging. He does not seem to have thought hard enough about how he can coax his countrymen to disarm, reconcile and recognise some form of authority besides the gun. A soft-spoken former militia boss, he speaks of returning to Mogadishu as if a soldier on the warpath.

And yet, for all Mr Yusuf's failings, his government is exciting some hope of success. Earlier this month, a delegation of its members persuaded militiamen to vacate Mogadishu's port, presidential palace and other government buildings.

Mr Yusuf credits these triumphs to the government's policy of including the brigands. “We have militia and faction leaders participating in the new government,” he told *The Economist*. “Since they are now part and parcel of the government they will disarm voluntarily as soon as we relocate the government.”

This seems over-optimistic. Even if Mr Yusuf succeeds in taking control of Mogadishu, he must then disarm some 50,000 militiamen, stop the influx of weapons, set up some kind of justice system and try to resurrect a stricken economy.

Those who see their power threatened will probably try to stop him. Somalia is home not only for a confusion of warlords, but also for smugglers and probably terrorists, too: America is actively searching for al-Qaeda operatives in the north. But despite all this, the exiled president remains sunny. His return to Mogadishu, he says, could hardly make the place more unstable than it already is.

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Europe awaits George Bush

When style and substance meet

Feb 17th 2005
From The Economist print edition

Reuters

The American president's visit to Europe is an impressive gesture in itself—but it will not untie every transatlantic knot

PRESIDENTIAL visits are always long on pageantry and symbolism—and George Bush's trip to Europe next week will be no different.

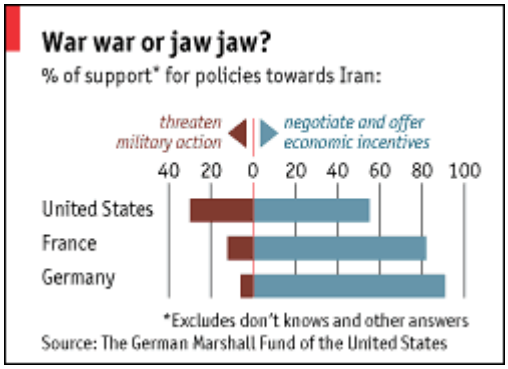
The president will spend three nights in Brussels, the headquarters of both NATO and the European Union. He will dine with Jacques Chirac, France's president, travel on to Germany for a separate meeting with Chancellor Gerhard Schröder, and finally to Slovakia, to see President Vladimir Putin of Russia. Simply by making such a long visit to Europe early in his second term, Mr Bush is sending a message: he wants to re-establish smooth and friendly relations with European allies. A president who has been widely portrayed within Europe as an arrogant, unilateralist warmonger will be keen to show his softer side. As José Barroso, president of the European Commission in Brussels puts it: “Sometimes in foreign policy, style is substance.” But it would be a pity if style alone prevailed, for there is a long list of issues to discuss.

• **Iraq:** The situation in Iraq remains the dominant issue of the day. Although several European countries have troops there—notably Britain, Italy and Poland—the European view has tended to be that the Americans are engaged in a struggling and mistaken venture, doomed to turn out badly. This view has shifted a little since the success of the Iraqi elections. And even before that, a feeling was growing in Brussels that Europeans should be seen to “reach out” to the Americans over Iraq. Gestures will be made during the Bush visit. NATO is likely to announce that all its members will contribute in some way to training Iraq's security forces—though they can choose to do so inside the country or outside. The EU will offer more aid and training for Iraqi police and judges. The Americans would prefer more European boots on the ground, but will welcome the fact that all EU and NATO states are making at least a token commitment.

• **The Middle East:** Here too, the atmosphere has become more positive. The death of Yasser Arafat and the election of Mahmoud Abbas seem to have opened the way for the more energetic American attention to peacemaking that Europeans had been urging. EU diplomats also say that Condoleezza Rice, the new secretary of state, is taking a slightly tougher line with Israel. But new divisions could start over Syria. America has withdrawn its ambassador to Damascus, after the murder of Rafik Hariri, Lebanon's ex-prime minister. The Europeans “so far” see no need to change their line.

• **Iran:** Americans and Europeans share a vision of a responsible, democratic and non-nuclear Iran. But the Americans have been sceptical about the usefulness of European diplomatic efforts to persuade the Iranians to abandon their nuclear ambitions. The Europeans fear the Americans are committed to “regime change” in Iran, rather than the preferred European option of a “grand bargain”—in which Iran might adopt a more responsible position, in return for the likes of WTO membership and IMF loans. Lurking in the background is fear among Europe's politicians, and voters (see chart), that Americans may use force—or sanction an Israeli attack—to thwart Iran's nuclear aims. This row is likely to be papered over during the visit. But there will be no meeting of minds.

•**China:** The United States is unhappy that the EU is moving towards lifting its arms embargo on China. The EU has tried to persuade the Americans this can be done without harming their strategic interests. On her recent visit to Europe, Ms Rice signalled that while her administration could reluctantly accept an EU decision—hedged around with sufficient safeguards—Congress was likely to react very unfavourably. The Europeans know that this is not bluff, and are nervous. But they are still likely to lift the embargo.


War war or jaw jaw?
% of support* for policies towards Iran:
threaten military action
negotiate and offer economic incentives
40 20 0 20 40 60 80 100
United States
France
Germany
*Excludes don't knows and other answers
Source: The German Marshall Fund of the United States

• **Kyoto:** When President Bush arrives at EU headquarters in Brussels, he will see, quite nearby, a giant inflatable balloon celebrating the entry into force of the Kyoto treaty on global warming: a not-so-subtle message to the visitor that Europe has kept Kyoto alive, despite his opposition. What the Europeans would love is some hint that the Bush administration may make a positive move over global warming, even if signing Kyoto is too much. Nothing will happen next week—although Britain is still hoping for an American shift during its presidency of the G8 rich countries' club this year.

• **The Balkans**: Something will have to be done about the status of Kosovo over the course of 2005. For once, the EU and America see largely eye-to-eye, agreeing that Kosovo is heading towards something like statehood. Objections to this are likely to come from Moscow and Belgrade.

• **The International Criminal Court**: The Europeans want to use the recently established International Criminal Court in The Hague to try possible crimes committed in Darfur. The Americans are opposed on ideological grounds and would prefer to set up an ad hoc tribunal, which the Europeans consider an inefficient solution. An EU diplomat comments acidly: “The Americans seem unable to decide which they hate more—genocide or the ICC.” This will not be resolved during the Bush visit.

• **The United Nations:** The impact of the oil-for-food scandal on the UN and on Kofi Annan, its secretary-general, has worried some in Europe. But Europeans reckon the Bush administration is backing away from efforts to unseat Mr Annan.

• **European integration**: Europe's governments are unsettled by signs of America reconsidering its traditional support for European unification. With Euroscepticism on the rise in Europe, an American effort to “divide and rule” could have a seriously disruptive effect. Ms Rice said some warm things about European unity on her recent visit to the old continent, and President Bush will do likewise. Behind the scenes, however, the Washington debate will continue. That is hardly surprising: while the Europeans will lay out the welcome mat next week, many do see the EU as a counterweight to America.

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Germany's foreign minister

A friend of America in need

Feb 17th 2005 | MUNICH
From The Economist print edition

A leftist's little local difficulty

Get article background

Reuters

Public charm, private rudeness

BOTH in his rebellious youth and in his current role as foreign minister, Joschka Fischer has personified a version of German leftism which—at least by European standards—is pro-American and pragmatic.

His political roots lie with the Greens of Frankfurt—who generally liked America's culture, and counter-culture—more than left-wingers in Berlin did. And in his present job he has always been keenly aware of the hard reality that in most international policy debates, all roads lead to Washington.

That does not mean he agrees with all Americans about everything. Two years ago, he had a memorable clash with Donald Rumsfeld, America's defence secretary, over the looming war in Iraq. He is still sceptical, in private, about American policy. But since the war he has made many fence-mending trips to Washington. This emollient side was on display last weekend at the Conference on Security Policy in Munich—where he had sparred with Mr Rumsfeld in 2003.

This time, Mr Fischer calmed a minor spat caused by Chancellor Gerhard Schröder. Without much warning to anybody, the chancellor had called for a “high-level panel” to review the role of NATO—on the ground that the alliance was “no longer the primary venue” for strategic deliberations between its members. What Mr Fischer explained to peeved Americans was that his boss was hoping to boost NATO, not disparage it.

Despite these diplomatic accomplishments, there is now a chance that the Americans may lose their street-fighting friend, who is also Germany's most popular politician. Mr Fischer is in some domestic trouble, and calls from the opposition for his resignation no longer sound ridiculous. On February 14th, Mr Fischer was finally forced to accept responsibility for some blunders over immigration. On his watch, Germany had allowed organised criminals to get thousands of illegal visas, many for prostitutes from Ukraine. Worse, despite police warnings, the foreign ministry was slow to stop abetting the sex trade.

Things my get worse for Mr Fischer, and his self-confidence—some say arrogance—is not helping. From the start, he underestimated the impact of the visa scandal, even after the opposition had launched a parliamentary inquiry. He has come to believe he has no match in domestic politics.

Another weak point is the animosity he can arouse among those who have to deal with him

directly, partly because he has the bad habit of dressing people down with little reason. Victims of this treatment—including German journalists—may relish a chance to bite back.

If he seems, on balance, likely to survive, this is mainly because without him Mr Schröder would have a hard time getting re-elected in 2006. The clumsiness of the chancellor's NATO initiative (which he could not explain in person because of illness) is a reminder of why he needs a foreign minister who is usually good with the Americans, if not always with his compatriots.

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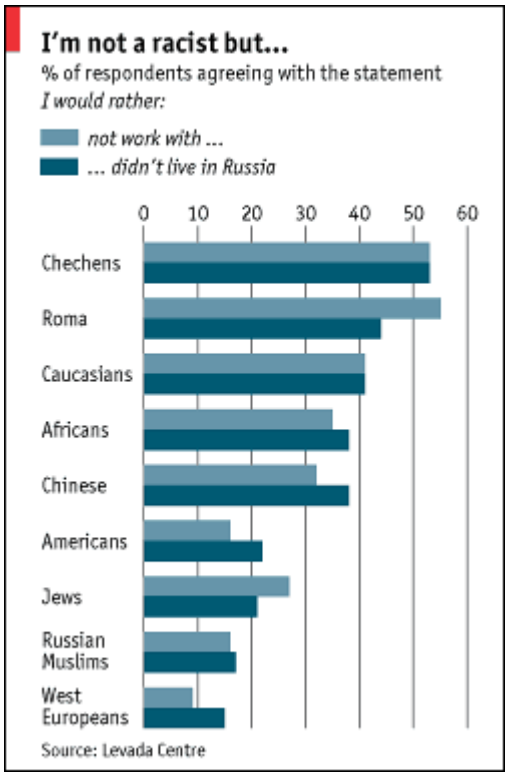
Russian xenophobia

The new Jews

Feb 17th 2005 | MOSCOW
From The Economist print edition

Behind a row over anti-Semitism, an older, broader intolerance



"I KNOW, I know. We are your chosen people," Tevye, a beleaguered Jewish milkman of the tsarist era tells God in "Fiddler on the Roof". "But, once in a while, can't you choose someone else?" Russia's old anti-Semitism resurfaced last month when several politicians joined a call for all Jewish groups to be banned. But these days, racism and racists in Russia have mostly chosen to victimise other minorities. In a dark corollary to the nationalist tone of politics, a broader kind of xenophobia is spreading.

Last week, two teenage North Korean students were shot and stabbed in St Petersburg—reportedly this was the fourth such attack on foreign students in the city this year. Last year in St Petersburg, a nine-year-old Tajik girl and a Vietnamese student were murdered. At the opposite end of the country, a North Korean was beaten to death in Vladivostok; and in Voronezh, in the heart of European Russia, a student from Guinea-Bissau was killed.

Many such crimes are committed by Russia's burgeoning "skinheads". The Moscow Bureau for Human Rights puts their number at around 50,000. Alexander Brod, the bureau's director, says there were 44 skinhead murders last year, and around 300 other attacks, figures that rise by about a third every year. An Indian medical student in Moscow says that because of skinheads, he ventures into the city centre only as part of a large group; and only in the morning does he dare to walk anywhere, even in his own neighbourhood, alone.

Accurate statistics for racist incidents are elusive, partly because police are slow to admit them. Moscow's police chief recently denied there were any skinheads in the city—perhaps, thinks Alexander Tarasov, a sociologist, because he has been told to concentrate on other challenges to authority, such as protests from the political left. Foreign students, in St Petersburg and elsewhere, can certainly testify that the police have little interest in protecting them.

There are two types of explanation for xenophobia. One stresses recent factors, such as Soviet disintegration, and the hardships of the 1990s. The skinheads—often unemployed youths who, as Victor Shnirelman, an analyst of Russian racism, puts it, "want to feel like winners, at least in their own cities"—fit this view.

So does the new hierarchy of Russian racisms. On one hand, anti-Semitism is still alive on the streets, as well as in parliament. Two rabbis were attacked in a Moscow underpass last month by a gang shouting “kill the Yids”. Alexander Lakshin, one of the victims, says that when he went into a shop, bleeding, to get help, he was told to leave. A vote-from-home television debate after the furore over the politicians' letter was won by an anti-Semitic Communist. Yet a variety of other groups are much more distrusted than Jews (see chart). People from the Caucasus in general, and Chechnya in particular, are most reviled, reflecting the resentment caused by two Chechen wars. Significantly, dislike of all groups from Russia's southern edge (who include some Christians) is stronger than prejudice against Muslims who come from central Russian regions like Tatarstan.

There was a spike of anti-Caucasian violence after last year's school massacre in Beslan. There are also everyday risks and insults. A scandal last autumn, when policemen manhandled a decorated Dagestani air-force colonel, has not stopped the harassment of Caucasians. Aslan, a Chechen living in Moscow, says the police seek extra-high bribes from his compatriots, while landlords and employers shun them. “Today it is us,” he sighs philosophically, “but yesterday it was somebody else, and tomorrow it will be somebody else again.” Clearly, recent events in the Caucasus have helped make Aslan's lot harder.

But a second school of thought blames Russian racism on older social and cultural forces, going back to tsarist Russia, that re-emerged as soon as they were allowed, and had never disappeared under Soviet rule, despite the ideology of fraternal love. After all, popular insults for Caucasians—resented since Soviet times for their domination of Moscow's food markets—are certainly not new coinages.

The deep roots of ethnically-based nationalism among the population at large strengthen this longer-term view. According to the Levada centre, in December some 59% of those polled sympathised with the idea of “Russia for the Russians”.

To what extent is the government to blame? Vladimir Putin, Russia's president, denounced the anti-Semitic letter. There is, however, a grey area between xenophobia and the sort of paranoid nationalism espoused by Mr Putin and mainstream politicians. What all these impulses share is an indecent haste to lay the blame on “others” for Russia's woes.

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Polish politics

Right turn ahead

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From The Economist print edition

As the ex-communists fade away, their rivals jostle for the spoils

Get article background

AN AIR of *fin de règne* hangs heavy over Poland. The Democratic Left Alliance (SLD), successor to the old Polish communist party, is on its way out of government and possibly out of existence.

Four years ago, it came to power with 41% of the vote. At the next election, probably in September, it will be lucky to get 10%. Scandals and splits have laid the party so low that even economic recovery cannot save it. The next government will probably be dominated by Civic Platform (known as PO, its initials in Polish), a right-wing party that is liberal on economic issues and conservative on social ones; it talks of cutting all the main taxes—personal income tax, corporate tax and VAT—to a common rate of 15%. Its first choice of coalition partner will be Law and Justice (known as PiS), which is more conservative across the board. (This week PiS helped to block a parliamentary debate on reforming a restrictive abortion law.)

Recent opinion polls give PO 27% support and PiS about 14%, probably enough for a parliamentary majority. Without one, they might have to work with the League of Polish Families, a Catholic nationalist party hostile to the European Union, which Poland joined last year.

That would be a volatile mix when the time comes for Poland to ratify the new EU constitution, probably by a referendum in autumn 2005 or spring 2006. PO dislikes the constitution, but will swallow it as a price of EU membership. PiS and the League of Polish Families are calling for a rejection, at any cost. Public opinion is broadly pro-EU, but low turnout could invalidate a referendum, leaving the decision to a more Eurosceptical parliament.

The succession to the SLD is still up for grabs. Last year one group of defectors set up a new party, Polish Social Democracy, hoping to distance themselves from the scandals dogging the government, led then by Leszek Miller. But the effect was merely to split the shrinking socialist vote, hastening the resignation of Mr Miller in May and his replacement by Marek Belka, a more consensual and technocratic figure.

Some think that Poland's well-regarded president, Aleksander Kwasniewski, may hope to lead a big new centre-left party when he steps down in September. If so, then Jerzy Hausner, deputy prime minister in the current SLD government, may already be acting as his stalking-horse. Last

week Mr Hausner resigned from the SLD, though not from the government, saying that he was tired of “existing political formations” and calling for the creation of a new “socio-liberal” party which was both pro-European and pro-market.

But even if Mr Kwasniewski has many of the qualities needed for leading a new centre-left party, his communist past would handicap him. The timing is also bad. With elections approaching, any new party must be built now, not in autumn.

This may leave an opening for the Freedom Union, a centrist liberal party which is trying to broaden its appeal. It lost all its parliamentary seats in 2001, but did well in last year's European Parliament elections, and feels the wind in its sails. It wants disenchanted socialists—such as Mr Hausner—to join forces with it.

An early election, which the right-wing opposition has long been demanding, would boost Freedom Union's hopes by catching the left in maximum disarray. But for exactly the same reason, the SLD would prefer to hang on. And since a constitutional majority is needed for the early dissolution of parliament, a late election in September seems more likely.

Against that, Mr Belka said when taking office in May that he would do the job for one year only. But he is likely to heed his party's appeals to stay. His quiet, disciplined style is much admired in the parliament, and in the financial markets. When Mr Miller was in charge, foreign investors feared that Poland was veering towards populism, fiscal crisis and ungovernability. Now they are queuing up to buy government debt, and the Polish zloty has soared in value (see chart). If Mr Belka can keep order until September, his country will owe him a mighty thanks.

One way to reward Mr Belka might be to elect him president, a largely ceremonial job, in succession to Mr Kwasniewski. But Wlodzimierz Cimoszewicz, the speaker of the parliament, seems to have the SLD nomination already tied up. The opinion polls favour two contenders from the margins of politics—Zbigniew Religa, a heart surgeon, and Tomasz Lis, a television news reader. But these outsiders will probably lose ground when the big parties start campaigning in earnest.

PO and PiS, though prospective allies in government, will almost certainly fight one another for the presidency. Lech Kaczynski, the PiS candidate, is slightly more popular than his PO rival, Donald Tusk, but PO will probably do better in mobilising the vote. Besides, Jan Rokita, PO's parliamentary leader and prime minister in waiting, will want to see Mr Tusk, the party leader, kicked upstairs. That way Mr Rokita, who is more conservative where Mr Tusk is more liberal, will have an even freer hand to reshape Polish politics for the next four years, and maybe well beyond.

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Ireland and Sinn Fein

Counting the cost

Feb 17th 2005 | DUBLIN
From The Economist print edition

A bank robbery comes at a high political price

Get article background

AP

Adams: how dare they call me a criminal?

TWO months ago it seemed entirely plausible to predict that Sinn Fein, the Irish Republican Army's political arm, might be a partner in government in both Belfast and Dublin before the decade was out. Only last October the Irish foreign minister, Dermot Ahern, said that Sinn Fein's participation in the Dublin government was just a matter of time—always assuming it dropped its paramilitary connection, and the IRA disarmed and then disbanded. Then, in December, Sinn Fein and the Democratic Unionist Party came close to a deal to share power in a restored executive in Northern Ireland, until republicans balked at demands by the DUP leader, Ian Paisley, for photographic evidence of acts of IRA decommissioning.

Everything has now changed, thanks to the £26.5m ($50m) bank raid on the Northern Bank in Belfast just before Christmas. Police chiefs on both sides of the border declare unambiguously that the IRA was responsible. The political fallout for Sinn Fein, which has denied IRA involvement, is giving the party its biggest headache in years. It could check Sinn Fein's electoral advance in both parts of Ireland.

The raid has severely strained relations between the Irish government and Sinn Fein, undermining the mutual confidence between the Irish prime minister, Bertie Ahern, and Sinn Fein's president, Gerry Adams. Last week, the Independent Monitoring Commission, which watches paramilitary activity, also publicly blamed the IRA for the raid. Senior members of Sinn Fein, an IMC report said, had sanctioned the robbery. In response, an angry Mr Adams stood outside the gates of the Irish legislature and protested his innocence, challenging the prime minister to arrest him.

Things have worsened rapidly since December, when the republicans rejected the Irish government's proposal that the IRA should promise to stop all its criminal activities. Now Mr Ahern feels duped, suspecting that Sinn Fein's leaders knew about the IRA's planned bank raid even as they sat in the negotiating chamber.

Sinn Fein has been winning votes across Ireland as it has been making the slow transition from a fringe group with an army into a proper political party. In particular, it has mobilised support among the poor working class in Ireland's urban areas, who might otherwise back the prime minister's party, Fianna Fail. In 1997 Sinn Fein won just one parliamentary seat and less than 3% of the national vote. In local elections last year, its share of the vote touched 8%. At that level,

the party might even hold the balance of power at the next general election, due by 2007.

Now its electoral strategy is in disarray. The idea had been that power-sharing in Belfast would be a stepping-stone to power in Dublin, by making Sinn Fein an acceptable partner in a coalition government. But talks on restoring the Northern Ireland executive may now restart only if Sinn Fein answers three questions to Mr Ahern's satisfaction: when will the IRA decommission its weaponry, cease its paramilitary activities, and end its criminality? Its criminal reputation has been strengthened by the recent pub murder of a Belfast Catholic, whose family have outspokenly denounced Sinn Fein and the IRA.

For now, Sinn Fein will be excluded from the peace process and any role in government—anywhere. Meanwhile, Sinn Fein may also find itself locked out of George Bush's White House, and struck off the guest list for his annual St Patrick's Day party on March 17th. To avoid excessive rudeness, all Northern Irish parties may be excluded. But the real reason will be to deny suspected bank robbers the pleasure of partying amid the shamrocks.

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Charlemagne

Meet the president

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A Maoist-turned-Eurocrat who learned his democratic lessons the hard way

GEORGE BUSH will meet many dignitaries during his three days in Brussels next week. These will include the secretary-general of NATO, the king of Belgium and heads of government from 25 European Union countries. Also waiting to receive him are the secretary-general of the EU's Council of Ministers, the president of the European Council (that is, the leader of the country that holds the Union's rotating chair) and the president of the European Commission.

Even the most dedicated student of European politics might be forgiven for wondering who among these jostling worthies actually speaks for the European Union. There is, in fact, no European counterpart to the American president—and probably there never will be. But if Mr Bush is looking for a partner who embodies and can speak for the European Union, that person is traditionally the president of the commission.

Fortunately for Mr Bush, José Manuel Durão Barroso, who took over as head of the commission in November, is an old friend. In his previous job as prime minister of Portugal, he hosted the Azores summit of 2003, in which Mr Bush, Tony Blair and José María Aznar of Spain prepared the ground for the invasion of Iraq. That decision endeared him to the White House, but still causes lingering distrust in parts of Europe; France and Germany would have preferred somebody else in the job.

Seated in his office in Brussels's Berlaymont building, the new commission president admits, with a mixture of amusement and exasperation, that he has “been accused of many things—of being an ultra-liberal, a counter-revolutionary” but adds: “I can assure you that none of it is true.” Such accusations are certainly ironic, given his history as a student Maoist in Portugal in the 1970s. That period of Mr Barroso's life is often written off as youthful indiscretion of little relevance to understanding the 48-year-old, multilingual technocrat of today. But, in fact, Mr Barroso's experience of living through Portugal's transition from dictatorship to democracy is fundamental to understanding his politics. Asked how he would explain his Maoist phase to an American visitor, Mr Barroso's initial reaction is to laugh and to say it would be impossible to understand for anybody who had not seen the Portuguese revolution.

But then he leaps up and returns from the neighbouring office with a framed photograph of the funeral of Antonio Salazar, the Portuguese dictator who died in 1970. Standing next to a candle-lit coffin is a dwarf brought over from the Portuguese colony of Angola and a giant from the colony of Mozambique. “Look at this,” he exclaims, “it was macabre, grotesque—but that was my country.” As a teenager, the young Barroso gradually realised that the official line—that Portugal was a great, respected state because of its empire—was belied by the reality of a poor, isolated and backward country on the periphery of Europe. Books and works of art that were freely available elsewhere were banned. “It wasn't just a question of not being able to read Marx,” he exclaims indignantly, “I wasn't allowed to buy that record by Jane Birkin, ‘*Je t'aime...moi non plus*'.”

Europe's civilising mission

At Lisbon University, he recalls, the only real opposition to colonialism and dictatorship came from communists of various schools. His Maoist period was a brief one. But the memory of those days has shaped him. Like many an Iberian politician of his generation, Mr Barroso associates his country's passage into the European Union with the end of isolation and the advent of prosperity and democracy. That has made him a passionate believer in the EU's power to spread peace and stability. But his personal experience of what it means to live under a dictatorship also makes him much less cynical than some other Europeans about President Bush's rhetoric on the subject of freedom. “Of course we can unite with the Americans in a fight for freedom,” he says: “freedom is a European concept.”

But while Mr Barroso has his romantic side, his early choices as commission president have been pragmatic. Previous occupants of the office—in particular the most famous recent incumbent, Jacques Delors of France—made their mark by expanding the powers of the Union, unleashing a torrent of legislation, and proclaiming their belief in the political unity of Europe and the glories of a unique European social model. Mr Barroso, by contrast, has focused on “jobs and growth”. He points out that all opinion surveys suggest these are the main concerns of EU citizens. Besides, the Union has only just expanded to include ten new members and has agreed an ambitious new constitution, which awaits ratification. “Some accuse me of lack of ambition for the EU,” says Mr Barroso, “but what could be more ambitious than trying to get this new Union of 25 countries actually to work and to produce greater prosperity?”

In a Union where several of the largest economies have unemployment rates of around 10%, it is indeed hard to argue with Mr Barroso's priorities. A more telling criticism is that the new commission president is setting himself up for disappointment by focusing on areas where he has few powers. The key structural economic reforms that need to be made in the European Union—in particular reforms to welfare states, labour laws and pensions systems—remain largely in the power of the individual members. Mr Barroso acknowledges that he has little authority to force through change, but hopes that the commission “can act as a catalyst”. But even in those areas where the Barroso commission can make a direct contribution to higher European growth, the early signs are not promising. An ambitious plan to liberalise trade in services across Europe has had to be pulled back for further “consultation”, after running into opposition in France and Germany. Persuading a reluctant Union really to pursue economic reform will be a tough slog. Fortunately, Mr Barroso knows the meaning of a long march.

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Education

Do better next term

Feb 17th 2005
From The Economist print edition

The biggest hole in the government's record—and how it may be fixed

Get article background

LABOUR activists and the educational establishment have a lot in common. It is not just that they prefer equality to excellence, and loathe any hint of elitism; they also have fundamental disagreements with the radically different approach of Tony Blair's government, which one lot notionally supports, and the other lot notionally serves. That paradox was exemplified in past rows over university tuition fees and tough school inspections. It will come up again next week when the new education secretary, Ruth Kelly, turns down the central recommendation of a big government-sponsored report into secondary education. This proposed a new diploma to replace the current system of GCSE exams taken at 16, and A-levels at 18.

For the educational establishment—meaning civil servants in the Department for Education and Skills, the local bureaucrats who run local education authorities, and the people in educational quangos such as the schools inspectorate and the body that regulates exams—the report had a lot to recommend it. It put academic and vocational qualifications on the same footing, and guaranteed prizes for all: leaving school without a diploma would be next to impossible. Many Labour Party people liked it for exactly these reasons.

But the government—meaning education ministers and the prime minister's policy unit—sees things differently. It wants higher standards, not soggier ones, plus more choice and more competition. That sort of thinking is anathema to people who think the country's main educational task is to use taxpayers' money to eradicate class privilege.

There is certainly no shortage of cash. There has been a 41% (£8.8 billion) real increase in the schools budget since 1997. Much of that has gone in higher salaries—a top head teacher can expect to earn well over £100,000 ($190,000) a year. The educational establishment's control over teacher training has been broken—making it possible for able graduates to become teachers in mid-career. A new £2 billion programme is overhauling run-down school buildings. But with generosity has come toughness: scores of bad schools have closed, and dozens of new ones opened. Seventeen of these are independently run, privately sponsored academies, which cost up to £26m each. These schools, loathed by left-wingers and local bureaucrats for their cost and elitist ways—uniforms, strict discipline and so forth—are a centrepiece of the government's secondary-school reforms. Less controversially, more than 2,000 schools have opted for specialist status in subjects such as languages, sport or science. That choice, plus finding a private sponsor willing to put in just £50,000, entitles them to more government cash. This has brought improved results, at least initially.

Yet overall results are still disappointing. Barely half of England's 16-year-olds (the rest of Britain and Northern Ireland run education differently) gain five GCSE passes, of grade C or above. And even that standard is wobbly. Those five passes, for example, can now include one all-

encompassing technology qualification that counts as four grades in individual subjects. And English and maths, which employers care about most, are not compulsory subjects. Even if rising exam results are taken at face value, they do not necessarily reflect the splurge on school spending. Results rose fastest in the first years of the Labour government—even though for much of that period it was still committed to the stingy spending plans of its Conservative predecessor.

The government is certainly open to the charge of gimmickry. Over the past eight years, a blizzard of initiatives on everything from truancy to careers advice has cost hundreds of millions of pounds and brought little. The government's anti-truancy programmes, for example, cost £885m, with negligible effect, according to the National Audit Office, a spending watchdog. A recent bright idea is a new television channel for teachers, of stupefying worthiness, costing £20m a year, which started broadcasting this month. It stars, oddly enough, an education professor noted for his unremitting hostility to the government's ideas. The latest scheme is personalisation: that may be an ingenious way of letting pupils concentrate on what they are good at—or it may simply add a new layer of complication to a system that is already unworkably barnacled.

The new academies may also prove to be gimmicks. They are expensive and hard to scale up. The government has cut the £2m minimum in cash required of private sponsors. But it is still struggling to find philanthropists willing to make the commitment. It seems odd that the government has pushed ahead with academies—200 are now planned—before waiting for an independent report on their value for money due out this month.

But the fundamental battle is about who controls schools. Old-style educationalists passionately support the idea of comprehensive, non-selective education as a social leveller. Without political restraint, they fear, head teachers will pick the best and brightest pupils, and shun the rest. The government now sees this thinking as the biggest obstacle to its reform plans. It wants to shunt the local education authorities into providing back-up services, such as school transport and provision for difficult, disruptive and specially needy pupils. Ambitious head teachers wanting to expand—for example by opening sixth forms—would be able to do so freely. Full plans on this are due after the election, although this week the government published new rules giving schools independently managed three-year budgets. That more than restores the autonomy granted by the Conservatives to around a quarter of the country's secondary schools by 1997. The government now privately admits that taking this away was its biggest educational blunder.

Good teachers, better buildings and more freedom will do a lot of good. Getting rid of central, local and quangocratic control will also help, if it happens. But there is no panacea. For a start, secondary schools will have to cope with the mutinous, dispirited 20% of pupils who arrive from primary school unable to read.

Secondly, so long as some schools are markedly better than others, it will be hard to manage admissions fairly. Labour shies away from selection by academic ability—but the current arrangements, which favour rich, pushy parents able to work the admissions system, for example by buying houses close to the best schools, is arguably even harder on the poor.

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Election campaigns

Aiming low

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Reuters

Party strategists have personalities, not policies, in their sights

PERSONAL attacks, digging up the past and dodgy grammar: the start of Britain's unofficial election campaign for the poll expected on May 5th suggests that attentive voters are in for a grim time. Labour's slogan—"Britain forward not back"—is meant to remind voters that the Tory leader, Michael Howard, was part of an incompetent government in the early 1990s. And the Conservatives, hoping to remind voters of Tony Blair's slipperiness, have chosen "accountability," a buzzword strikingly short of buzz.

Labour has circulated posters on the internet starring Mr Howard. One showed him as a sinister, black-clad hypnotist, and another as a flying pig. Some said they were anti-Semitic (Mr Howard is Jewish); many spotted the brutal hand of Alastair Campbell, the prime minister's former spin chief.

With matching vigour, the Tories have attacked Mr Blair's wife for profiting from a charity speaking tour. More of that may so repel the voters that turnout falls below the dismal 59% of 2001.

So why do politicians do it? Each party thinks the other's leader is its weak point. Personal attacks sharpen the choice between the two parties, when many differences are slender. Whatever else distinguishes this election, it will not be marked by a clash of ideas. Tories and Labour alike want more independence for schools and better discipline in them; they want cleaner hospitals and more choice for patients, and tighter controls on immigration. The main difference is that even when Conservative policies are more popular, on tax for example, voters doubt that the party will deliver them.

An extra reason for Labour to fight a dirty, personal campaign may be to stave off what might be well-founded complacency among its supporters. A recent Populus poll for the *Times* showed Labour extending its lead to 41%, fully nine points clear of the Conservatives. An unspoken

campaign aim for Labour is to prevent the Tories from gaining enough seats to have a chance of winning even in 2009. That might appeal to Labour activists, but it won't fire up ordinary voters. Hence the attempt to stoke fear by focusing on Mr Howard's supposed nastiness.

On the non-nasty level, Labour is repeating the tactic it used in 1997 and 2001, of issuing pledge cards—with five promises then, and six now. They are hardly demanding, being both vague and overlapping (as well as verbless): “Your family better off”, “Your child achieving more” and “Your children with the best start” sound like one unarguable proposition, not three.

Until recently, the Tories have struggled to gain any attention for their policies. Under the scrutiny of the campaign, they are faring better than they feared. Their spending plans have not been unpicked by Labour. And, for once, they appear to be making the political weather with hardline policies on immigration, one of the few issues where polls suggest they have an advantage. Labour strategists seem to agree. Rather than condemn Tory proposals for their unpleasantness, the government insists that it is being just as tough, but more practical. This week, the Tories said immigrants should take tests for various unpleasant diseases before they come to Britain. Des Browne, the immigration minister, says something similar is already in the works.

If Labour and the Tories are successful in reminding the public what they dislike about the two main parties, they could help the untarnished Liberal Democrats to make gains. In any case, as the election nears, they will benefit from increased access to the airwaves. Moreover, personal attacks are unlikely to work against the Lib Dems' genial leader, Charles Kennedy: few voters know much about him. But what they do know, they tend to like.

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Anti-terrorist legislation

The stuff of nightmares

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A new anti-terrorist bill faces a rough ride from the courts and Parliament

INDEFINITE detention without trial of foreign terrorist suspects is “incompatible” with human-rights laws, as well as “discriminatory” and disproportionate, Britain's highest court ruled in December.

Since then the government has been trying to work out what to do. Next week it will introduce new legislation providing for the indefinite house arrest without trial of terrorist suspects, whether British or foreign. Under plans unveiled last month, Charles Clarke, the home secretary, would be able to impose a range of “control orders” on anyone he has “reasonable grounds” to suspect “is, or has been, concerned with terrorism”. As well as house arrest (a phrase he eschews), they include curfews, electronic tagging, a ban on the use of telecommunications and restrictions on contact with named individuals.

Tories, Liberal Democrats and many Labour left-wingers are dismayed. Even George Churchill-Coleman, a former head of Scotland Yard's anti-terror squad, says the new measures are impractical, unethical and will further marginalise Britain's Muslims. “I have a horrible feeling that we are sinking into a police state,” he told the *Guardian*.

Lord Goldsmith, the attorney-general, fears privately that the new measures could face a new challenge in the courts. But Mr Clarke hopes they will pass: if necessary, he says, he will seek a new derogation from the clause in the European Convention on Human Rights that guarantees a right to liberty. Britain has already had to seek such an opt-out for that part of its anti-terrorist legislation now ruled unlawful. No other European nation has done so.

Under the convention, derogation is permitted only “in time of war or other public emergency threatening the life of the nation”, and then only “to the extent strictly required”. The government argues that the threat of international terrorism is just such a “public emergency”.

This is now being challenged in the European Court of Human Rights by nine foreigners held in Britain without trial for the past three years. If they win, it could wreck the government's house-arrest plans. In their December ruling, the law lords had already queried the government's justification for its derogation. The resulting indefinite imprisonment without charge or trial was “the stuff of nightmares”, Lord Scott said.

Legal challenges aside, the government may struggle to get the new law through Parliament, especially the House of Lords, where Labour does not have a reliable majority. Tony Blair, the prime minister, was due to meet opposition leaders on February 18th to try to find a compromise. One idea is that a judge, rather than the home secretary, would order house arrest.

Opposition parties also want wire-tap evidence admitted in court, as already happens in the United

States, Canada, and Australia. This, they argue, would make prosecution and conviction of terror suspects easier—so there would be less need to hold them without charge at home or in prison. Ken Macdonald, the director of public prosecutions, agrees. But the government, backed by the spooks, doubts that more convictions would result.

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Scottish diplomacy

The Caledonian circuit

Feb 17th 2005 | EDINBURGH
From The Economist print edition

Edinburgh is Britain's second diplomatic capital. What do they all do?

IN THE cold war, Edinburgh was a base for Soviet-bloc spies interested in Scotland's NATO bases, and for diplomats wanting to know if Scottish nationalists might shut them. Those days are gone, and nationalism has waned. But oddly, the diplomatic corps has swollen.

Over the last decade the number of full-time foreign missions in the city has doubled to 16. They are still growing—the Swiss are due to shift their Manchester consulate northwards later this year. Equally, the number of Scottish officials working on “external relations” (called that in order not to pique the besuited smoothies of the British Foreign Office) has shot up to about 25, of whom half a dozen work in Brussels, Washington, and soon Beijing.

Trade, tourism and culture, and the lukewarm cocktails of the diplomatic circuit have largely replaced spookery and seduction. Vladimir Malygin, the Russian consul-general, says his is a “very active post, with very many receptions to attend.” Like most diplomats in Edinburgh, he professes fascination at the workings of devolution. That could be true: by the standards of separatist movements elsewhere, Scotland is a peaceful success story.

Scottish bureaucrats have had to learn diplomatic protocol. Mr Malygin found the Scottish executive uninterested in having him present his credentials—just a mix-up, say officials. Other foreign envoys find it irksome that the first minister, Jack McConnell, concentrates so much on China and America. His outfit for the New York Tartan Day parade last year—a micro-length grey pin-stripe kilt—prompted ridicule rather than interest in Scottish fashion. But at least it gave the diplomats, stuck in what many see as a career-busting backwater, something to talk about.

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Police reform

Handcuffed

Feb 17th 2005
From The Economist print edition

Proposals to strengthen public control over the police do not go far enough

Get article background

THESE days, everybody agrees that Britain's police ought to be more accountable to the people they serve. The Conservatives beat the drum for democratic control on February 10th, promising elected “police commissioners” to push the coppers into doing what ordinary folk want them to do. The following day, Tony Blair touted the idea of more local policing teams to crack down on the sort of low-level crimes that most upset people. Splendid stuff—but odd, given that both parties have used their time in government to undermine local control over the police.

Britain's police officers have never been as directly accountable as America's. That is partly because they cling stubbornly to ancient traditions of operational independence. But a bigger problem is multiple ownership. While America's police forces are either under federal or state or city control, the 43 regional forces of England and Wales are ruled both by national politicians and by “police authorities”—low-profile outfits composed of local politicians and citizens. Muddled governance has been the result; but, as in many other areas of life, the centre has gradually taken power from the locality.

At present, the police receive four-fifths of their funding and nearly all their steer from central government. Control is exercised through targets and “performance indicators” covering everything from the number of car crashes per 1,000 people to the amount of time officers spend behind their desks. Miss these targets and the result is more inspections, less funding and (for senior officers) interrupted careers.

Central control has intensified recently, according to Peter Neyroud, chief constable of Thames Valley Police: “It only takes one or two months of poor data for you to find yourself on the radar.” The targets have also become more illogical. The government's Office for Criminal Justice Reform wants Mr Neyroud's force to record 12.2% fewer crimes while dealing with 25% more offenders—tricky, since the best way of collaring more crooks is to crack down on petty crimes that would otherwise go unrecorded.

Another problem with targets, says Tony Arbour, leader of Richmond council in London, is that they take no account of local priorities. People in his district suffer less from commonly targeted crimes such as burglary and robbery than other Londoners. But they want more visible policing. Their demands are overlooked in the scramble to hit city-wide targets.

The Conservatives' solution to this mess is to do away with the targets and the police authorities, replacing them with an elected police commissioner for every police force. Together with chief constables, the commissioners will decide what the police will focus on and how much local taxpayers ought to contribute.

These proposals are bolder than the faltering steps towards local control so far taken by the Labour government. The neighbourhood policing teams pledged by Mr Blair are already present in some areas, with more planned. Supposedly more in touch with local demands, they are nonetheless bound by national crime-cutting priorities. “We have got symbolic local policing combined with stronger central control than ever before,” says Barry Loveday of Portsmouth University.

Elected police commissioners might be an improvement on centralised, bureaucratic control. But Mr Loveday believes both Labour and the Tories are missing the obvious solution. Handing control over police budgets and senior appointments to mayors and local authorities would bring more accountability without needing more officials. It would also stop further diluting the powers of local government—which, after all, is what made the police so distant in the first place.

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London's Olympic bid

Smothering the flame

Feb 17th 2005
From The Economist print edition

Ken Livingstone's timely intervention

SMILE please. The International Olympic Committee (IOC) is in town this week to assess London's fitness to hold the games in 2012. The proposed budget is £2.4 billion, underwritten by the Treasury but paid for chiefly by the poor (through a lottery) and the disaffected (Londoners, who are already highly taxed). The games might end up costing more, though: the latest estimates from the Greek government are that the Athens games cost €8.8 billion (£6 billion)—almost double the original budget.

London has some fine plans. But the three main arguments for the bid have holes. First, the Olympics would prove that the city can hold a big sporting event. But, as Athens shows, a city has to want to boost its reputation very badly for the games to be worth it. Second, it would promote sport. Fine, but why not subsidise people who play sport, rather than those who watch it? Third, the games would force the city to fix its transport system and regenerate a drab bit of east London. But if this is worthwhile, why not do it anyway? Similar claims were made in Athens, where expensively constructed showpiece sites are already decaying.

During their stay in the city, IOC members will have dinner with the queen and, as a reward, sit through hours of computer slideshows. They will also be driven at high speed through a hole in the ground that will eventually form part of the Channel Tunnel rail link.

If that doesn't frighten them off London's bid, then a bizarre and strangely timed outburst from Ken Livingstone, London's mayor, may help. After being badgered for a quote by a reporter from London's *Evening Standard*, a paper he loathes, Mr Livingstone asked him if he had previously been a “German war criminal”. After the reporter revealed he was Jewish, Mr Livingstone dug his hole deeper, continuing: “Ah right, well you might be, but actually you're like a concentration camp guard, you are just doing it because you are paid to, aren't you.” Despite all-party censure, and urging from Tony Blair, Mr Livingstone still refuses to say sorry.

Londoners are used to their mayor's foul-mouthed bad temper and extremist antics, but they do not believe he is anti-Semitic. So the row will pass. But the IOC may be less resigned to the city leader's odd behaviour. Olympiaphobes will be crossing their fingers.

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Interest rates

Push me, pull me

Feb 17th 2005
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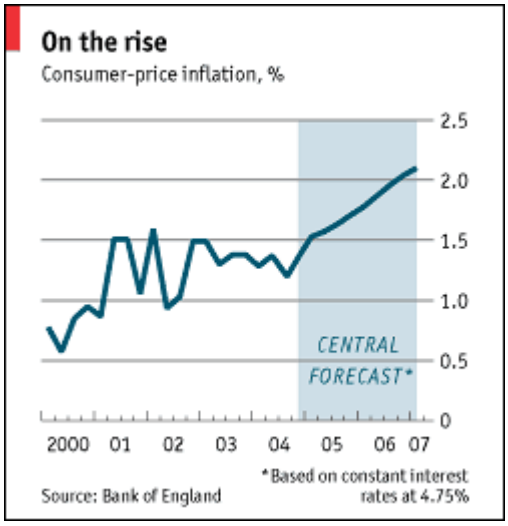
Will the Bank raise rates again? Only if labour costs surge

Get article background

THE Bank of England has held interest rates at 4.75% since last August, leading many to hope that they have peaked. On the face of it, the Bank's latest economic forecasts in its quarterly *Inflation Report* dash this hope. Yet a further hike in interest rates is not a done deal.



Since the Bank's last report in November, economic growth has picked up. Following a soggy third quarter when GDP grew by a below-trend 0.5%, it rose by 0.7% in the final three months of the year. A second factor is that consumer-price inflation has also gone up. The annual rate has risen from a recent low of 1.1% last September—well below the government's target of 2.0%—to 1.6% in January.

The Bank thinks that the economy is operating at around capacity and it expects somewhat stronger growth in 2005 than it did last November. As a result, its central projection shows that with rates held at 4.75%, inflation will reach the target rate of 2.0% towards the end of next year and will carry on rising (see chart).

Changes in interest rates take 18-24 months to have their full effect on inflation. So why did the Bank leave interest rates at 4.75% when it met earlier this month? The answer is that its monetary-policy committee (MPC) takes into account not just the main forecast but the risks around it. “Overall, the committee judges that the balance of risks is somewhat to the downside”, said Mervyn King, the Bank's governor, when presenting the *Inflation Report* on February 16th.

The MPC's main worry is that consumer spending may slow down more than expected. Its central forecast is for consumption to increase at around its average rate over the past three years. But in the fourth quarter of last year, consumer spending seemed to slow, with retail sales falling in December.

The main threat to consumption is the downturn in the housing market. The Bank thinks this will have a relatively limited effect on consumer spending, but it cannot be sure. Jonathan Loynes, economist at Capital Economics, a consultancy, thinks that the MPC is being too sanguine.

If labour costs rise more than expected, that could stoke inflation. Mr King said “all indications point to a tight labour market with potential upward pressure on earnings”. Although unemployment has edged up to 4.7%, it remains at its lowest since the mid-1970s. And earnings

growth continues to pick up. Excluding bonuses, average earnings are rising at 4.5%, the highest for three years. Ominously, that is also the rate that the Bank thinks is compatible with hitting the inflation target.

So the Bank has sensibly adopted a policy of wait and see. If consumers are indeed retrenching in response to the housing market slowdown, interest rates are likely to have peaked. And if wage inflation continues to creep upwards, they are likely to rise again.

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Libel law

Who pays for libel?

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From The Economist print edition

The European Court challenges Britain's libel laws

IT WAS the longest trial in British history. In 1990 McDonald's, an American fast-food firm with more than 1,000 restaurants in Britain, sued Helen Steel and David Morris, two environmental campaigners, for libel, after they had handed out leaflets accusing it of torture, murder, destroying rainforests and exploiting children. Eventually, after a trial lasting 313 days, Steel and Morris were found guilty, and (after an appeal) were ordered to pay damages of £40,000.

But the legal battles did not end there. In 2000, Mr Morris and Ms Steel took the government to the European Court of Human Rights. On Tuesday, the court ruled in their favour. It found that, because British law did not then allow legal aid for libel cases, and because of the imbalance of the legal teams (McDonald's hired a team of high-flying lawyers; Mr Morris and Ms Steel represented themselves) they had not received a fair trial. It also ruled that, because of the size of the damages awarded, the trial had been a violation of the defendants' freedom of speech. It ordered the government to pay them €82,000 (£57,000).

Will the ruling force a change in Britain's eccentric libel laws? The pair's lawyers certainly think so. Mark Stephens, a solicitor who gave them free advice in the original trial, and was part of the legal team for the European trial, reckons that the state will have to start providing legal aid for libel defendants, and that damages may have to be awarded according to the defendant's ability to pay. Keir Starmer, their barrister, called it a “turning point in English law.”

Others are less sure. Geraldine Proudler, another lawyer, points out that new laws introduced in 2000 may mean the government can get away with only minor tinkering. Legal aid is now available “in exceptional circumstances” for libel cases. Had that applied in 1994, the McDonald's case might have qualified. And “no-win, no-fee” agreements, also introduced in 2000, provide another route for impoverished litigants.

True, says Mr Stephens, though that applies only to the prosecution. Victorious libel defendants don't get damages, which means that “no-win, no-fee” lawyers will be reluctant to take them on. But lawyers may work free of charge for reasons other than the possibility of fat payouts: publicity, say, or even a desire for justice. After all, that was what Mr Stephens did.

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Bagehot

The end of the affair

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Tony Blair is right to be worried about his unpopularity

Get article background

IT IS a characteristic of charmers that when they suspect they may have caused offence, they calculate that a sufficiently charming apology should get them off the hook. But the trouble with charm is that it makes things worse if the people it is aimed at have seen through it. Which is why Tony Blair's attempt last week to confront his own unpopularity by talking like a marriage-guidance counsellor about his relationship with the voters had most people reaching for the sick-bag.

To get the full flavour of Mr Blair's speech at Labour's "spring conference" (in effect, the start of the party's campaign for re-election), one excruciating passage demands repetition: "So after the euphoria came the steady, hard slog of decision-making and delivery. And the events that tested me. And the media mood turning, and friends sometimes being lost as the big decisions mounted, and the thousand little things that irritate and grate, and then, all of a sudden, there you are, the British people, thinking: you're not listening. And I think: you're not hearing me. And before you know it, you raise your voice. I raise mine. Some of you throw a bit of crockery." He went on to confess to having appeared arrogant, but said that now he had discovered humility: "And I learnt that the best policy comes not from courting popularity or mere conviction, but comes from partnership between politics and people, from the blend of listening and leading."

If, as is alleged, this sanctimonious tripe was the work of Alastair Campbell, restored to Mr Blair's side for the election campaign, it was a far greater offence against decency than the expletive-laden e-mail recently propelled by Mr Campbell's thumbs from his BlackBerry to "Newsnight", a BBC current-affairs programme. Nonetheless, by choosing to talk about it himself, Mr Blair raised two interesting questions: why do so many people now loathe him and what effect will it have on Labour's election prospects?

The obvious answer to the first question is spin and Iraq. But those are really just shorthand for a lot of other things that, as Mr Blair so rightly says, "irritate and grate". The problems began with the contrast between the do-nothing first term, when the priority was to establish economic competence, and the expectations that Mr Blair had raised with his shiny-faced evangelism and his talk of Labour's "healing" policies making Britain a "young country" again. With spending on a tight leash, the government fell back on the relentless hyping of inconsequential initiatives designed to feed the 24-hour news machine and give an impression of activity. By the time—after the 2001 election—that Mr Blair had both some idea of what needed to happen and the money to back up his ideas, he recklessly ratcheted the hype several notches higher. New Labour was "at our best when at our boldest"; yet the reality was cautiously plodding reform. Public services were to be "transformed", when the reality was grindingly slow incremental improvement.

Even if Iraq had never happened, Mr Blair would still be in trouble with the female voters he

successfully wooed eight years ago. The evidence of qualitative opinion research suggests that most women see politics very differently from men. They take a severely practical view of politicians, judging them on whether their children's school or their family doctor's surgery has improved. They are more infuriated than men by the gap between high-flown rhetoric and the prosaic facts on the ground. Combine that frustration and cynicism with Mr Blair's determination to fight, as they would see it, an unnecessary war on false pretences and it is no wonder that the prime minister's standing with female voters has fallen. According to a Populus poll for the *Times* last month, only 33% of women were prepared to say that Mr Blair was a good prime minister compared with 39% of men.

Labour's fear is that many of the women who came over to Labour in 1997 and voted for the party again in 2001 will either not vote or turn to the Liberal Democrats. Do not be surprised if Mr Blair's grinning face is left off Labour's campaign posters and many candidates' election leaflets.

Labour's other fear is that Tory voters, by contrast, have been energised to vote by a distaste for Mr Blair that comes close to hatred. When Mr Blair became prime minister, a lot of Tories, not least Margaret Thatcher, were willing to concede that for a Labour leader, he was not at all bad. That has changed.

Perhaps surprisingly, Conservative supporters now tend to be more hostile to the war and President Bush than Labour voters. They resent seeing Mr Blair strutting the world stage and many of them instinctively recoil when Mr Bush and Mr Blair bang on preachily about spreading liberty and democracy. They compare Mr Blair's enthusiasm for Europe unfavourably with Gordon Brown's apparent scepticism. But most of all they detest Mr Blair for keeping their party from power by the ruse of clothing himself in Tory policies.

Love me, love my party

Mr Blair is right to be worried that a combination of stay-at-home (mostly female) former Labour supporters and a fired-up Tory base could make the election closer than polls currently indicate. While it is true that Mrs Thatcher's unpopularity had little effect on the size of her majorities, her “offer” was never based on having to like her. Mr Blair, on the other hand, implicitly asked people to vote for him even if they didn't care for his party. His pitch was: “*New Labour, c'est moi*.”

Paradoxically, last week's speech aside, Mr Blair is actually now rather less annoying than when he cultivated adoration. Tempered by experience, he is more realistic and consequently more effective. He has learned the hard way to restrain the temptation to over-claim. There are times when he even seems to wear his current unpopularity as a badge of honour. That may in itself be hubristic, but it is preferable to what went before.

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The town of the talk

Feb 17th 2005
From The Economist print edition

Alamy

After the twin-tower nightmare, New York is back on form, says Anthony Gottlieb (interviewed here)

WANDER into “Avenue Q” at Broadway's Golden Theatre and you can see the best current incarnation of an old New York favourite: a musical about the town that invented musicals. The show features a group of young hopefuls who are, for now, consigned by the city's high rents to a fictitious street in an outer borough. If today's twenty-somethings could afford a Broadway ticket, they would be nodding appreciatively.

The story is also true to life in another way, which it may not have intended. Some of the characters are people, some are humanoid glove-puppets, and some are green or covered with hair. The real New York is not quite as ethnically diverse as that, but it is getting there. In the 1990s, immigrants flooded into New York in greater numbers and from more countries than ever before. The city's population has reached an all-time high of 8.1m, and a higher proportion of its people—over 36%—are foreign-born than at any time since the 1920s. Los Angeles and Miami have an even larger proportion of immigrants, but New York's are far more diverse. Over half of Miami's new arrivals are Cuban, and over 40% of Los Angeles' are Mexican. In New York, the Dominican Republic provides the biggest chunk of immigrants, with a share of 13%. China comes next with 9%, then Jamaica with 6%. No other country has more than 5%.

The impact of these multifarious new New Yorkers is easily summed up. They saved the city, and they are helping to rebuild its neglected neighbourhoods. In the disastrous 1970s, New York lost 10% of its population and more or less went bankrupt. Without the influx of some 780,000 foreigners in that decade, things would have been much worse. And ever since then, immigration has helped New York to avoid the decline that beset most of America's other big old cities. Now immigrants make up 43% of the city's labour force, including over a third of its workers in finance, insurance and property, over 40% in education, health and social services, more than half in restaurants and hotels, 58% in construction and nearly two-thirds in manufacturing.

Up and coming

When *The Economist* last surveyed New York, in 1983, it said the city needed to strike more of a balance between rich Manhattan at its core and its four partly decaying outer boroughs of Brooklyn, Queens, the Bronx and Staten Island. Manhattan is still enormously wealthy. The residents of just 20 streets on the east side of Central Park donated more money to the 2004 presidential campaigns than all but five entire American states. But many of the most wretched neighbourhoods of 20 years ago—in south Bronx, central Brooklyn and Harlem—have seen a remarkable renaissance.

Most immigrants live in the outer boroughs, two-thirds of them in Queens or Brooklyn, where they build businesses and often homes. Flushing in Queens, whose population is now nearly two-thirds immigrant, is a striking example. Poor and virtually all white in the early 1970s, the place is now Asian and flourishing. Across the city there has been a boom in housing construction. From the start of 2000 to July 2004, permits for about 85,000 new units were issued, almost as many as in the whole of the 1990s. And nearly half of all new housing in the past seven years is reckoned to be occupied by immigrants or their children.

New York is once more where the young want to go, whether it is to take up a high-paying job on Wall Street, to study, or to vegetate on Avenue Q whilst figuring out which of the city's opportunities to aim for. New York University is now the most popular in America, according to a survey of college hopefuls by the *Princeton Review* in 2004. Its number of applicants for undergraduate courses more than doubled from 1995 to 2004. More graduates from America's top business schools go to New York than to any other city. For the less well-heeled, a little creativity may be required to pay the rent. At a subway stop on 57th Street, a student busker plays the “Godfather” theme with her saxophone held sideways like a flute, to accommodate a well-twirled hula-hoop. The effect is a pleasing vibrato.

The city is bubbling with more conventional attractions, too. After a renovation project that cost $858m, the Museum of Modern Art unveiled its new building in November. It hiked its admission charge from $12 to $20 but is packed. A couple of weeks earlier, Jazz at Lincoln Centre opened its concert spaces, run by Wynton Marsalis, a jazz trumpeter, in the angular twin towers of the new Time-Warner Centre (TWC) at Columbus Circle. The TWC is the headquarters of Time-Warner, but also houses a shopping mall (the first real one in Manhattan, which is causing shudders), some of the most expensive apartments in New York and two restaurants where it would not be hard to spend $1,000 on dinner for two.

Worlds away downtown, countless cheaper joints are jumping. According to Moby, a techno musician who owns a vegetarian restaurant on the Lower East Side, ten years ago there was nowhere in the area for bands to play. Now there are if anything too many venues. With at least 850 bars and clubs all over the city, the competition can be fierce.

One big reason why New Yorkers have been able to rescue their neighbourhoods, attract people and smarten up the city is a dramatic fall in crime, which began in the 1990s and continues apace. Once notorious for its threatening streets, graffiti-covered subways, drug-addled hobos and general air of menace, New York today—as its businessman-mayor, Michael Bloomberg, rightly never tires of saying—is the safest big city in America. Now that

New Yorkers are comfortable lolling on the sidewalks, eating outside and moving around the city, the trend is self-reinforcing. They have reclaimed their streets.

Street smarts

Rudy Giuliani, who was mayor in 1994-2001, is usually given the credit for transforming the city with his introduction of “zero-tolerance” policing. He did indeed demonstrate that crime can be driven down and kept down. He showed that the city was manageable, which was a great legacy to leave. But the conquest of crime did not happen quite as New Yorkers think they remember it. The virtuous cycle was started when David Dinkins, a black former mayor who is now rarely credited with anything, raised taxes to hire thousands more police in 1990-93 and crime began to drop. And it was Mr Dinkins's police commissioner, Ray Kelly—now back in the job again under Mr Bloomberg—who began the campaign to stamp out windscreen-washing “squeegee men” and other minor annoyances before they turned into something nastier. It helped, too, that the city's crack-cocaine epidemic was ending anyway in 1991.

From the late 1960s to the early 1980s, films showed the world that New York was steeped in sleaze and violence. The image of the city portrayed in “Midnight Cowboy”, “The French Connection”, “Death Wish”, “Taxi Driver” and “Fort Apache, the Bronx” took time to fade. But in the 1990s three yawningly peaceful sitcoms broadcast a very different picture of the city, supplanting menace with safer kinds of urban adventure. They were tinged with just enough hedonism and cynicism to attract young people without risking their parents' disapproval. The three are “Friends”, in which nothing happens, “Seinfeld”, in which even less happens, and “Sex and the City”, where plenty happens, but usually to someone else.

“Sex and the City” stars four young career women and is ostensibly about the difficulties of finding a man in New York. It has a point. According to an analysis for *The Economist*, there are 93 men to every 100 women among single New Yorkers aged 20-44. In the country as a whole, and in most other big cities, there are more young single men than young single women. What the programme mostly shows, though, are the joys of chatting, shopping and going out to glamorous places. The six young friends in “Friends” are poorer and don't have quite the right invitations. They hang out together, discuss who is hanging out with whom, then hang out some more. “Seinfeld” is about a self-satisfied comic who occupies himself by being mildly witty about the trivial frustrations of urban living and his eccentric neighbours.

Volume, mass and destiny

All three programmes show New York as essentially one big conversation, which is why they reflect and sell it so well. For this is the town of the talk—a town of irrepressible boosterism somehow combined with deprecating and ironic Jewish humour, of endless argument and opining, of making deals, exchanging ideas and remaking lives through meetings that seem pure chance but are inevitable given the city's buzzing density. Manhattan's confined grid of streets packs together not only the 1.5m people who live there but also 2.4m jobs, and the lion's share of the city's huge number of visitors. As the capital of the nation's media, it is the place where America talks to itself. Most of the news networks and late-night talk shows, the two almost-national quality papers, the news weeklies and the book publishers are here. Discourse and intercourse—in the broad sense of that word—are the essence and the comparative advantage of New York. This survey will argue that the jobs which thrive here are those that require or exploit the interaction of people jammed together.

Yet density brings a small risk of great danger. New York is a strikingly healthy place to live, and was so long before Mr Bloomberg began to wage a war on smoking in 2002. Partly because there is no room for many cars—so New Yorkers are highly unlikely to be killed by them, and take more exercise—New York has the lowest mortality rate of all but three of America' s 46 biggest cities. But, as the journalist and author E.B. White pointed out long ago, the highly concentrated splendour of New York also makes it a tempting target for any “perverted dreamer” with the power to “loose the lightning of annihilation”. With what now seems like chilling prescience, in 1948 he wrote:

> A single flight of planes...can quickly end this island fantasy, burn the towers, crumble the bridges, turn the underground passages into lethal chambers, cremate the millions. The intimation of mortality is part of New York now: in the sound of jets overhead, in the black headlines of the latest edition.

Three-and-a-half years after New York's blackest headlines, the island fantasy is evidently far from ended. Jobs are growing (just), Wall Street bonuses are up, and last year there were more visitors than before the attacks. But then the numbers killed were not the millions White envisaged; he was thinking of nuclear bombs.

Leave out the passengers and crew on the aeroplanes that were flown into the World Trade Centre, and about 2,600 people were killed in New York on September 11th 2001. Put that tragic number in perspective, and you can perhaps see how it is possible for New York to be a powerful magnet for talent, youth and energy once more. In 1990 there were 2,290 murders in the city; last year there were 566. Thus even if a September 11th were to occur every other year, the city would by one measure be quite a lot safer than it would be with crime at its 1990 level and no terrorism.

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Bridging the gap

Feb 17th 2005
From The Economist print edition

The next cool places to live

Eyevine

Well-connected Brooklyn

PROPERTY values in all five boroughs have grown strongly since the terrorist attacks, according to the city's property-tax assessors. But home prices in Manhattan are rising especially fast. At the end of last year, the median price of an apartment on the island was $670,000, over 15% higher than a year earlier and more than three times what it was in 1995, according to Miller-Samuel, a property consultancy. As Manhattan's established areas climb out of reach, young professionals colonise and upgrade other neighbourhoods. People are getting used to the idea of a $1m house in Harlem.

This has been the story of Manhattan for as long as anyone can remember. Now it is happening to the outer boroughs too. Parts of Brooklyn, especially, have been yielding to gentrification, thanks to good subway links to downtown Manhattan, pretty brownstone houses and parks. First it was Cobble Hill (already passé: CBS plans to air a sitcom about thirty-somethings in Cobble Hill this summer), then Park Slope, now Williamsburg.

The writing is literally on the wall. Under an awning outside a restaurant in Williamsburg last November hung a poster about a proposed waterfront development: “Think your rent is high now? Wait until these 22 luxury high-rise towers go up!” On the other side of its entrance flapped a poster twice as large: “Le Beaujolais Nouveau Est Arrivé.”

Areas of Brooklyn now house many of the city's young writers and journalists, and are in effect becoming Manhattan's left bank. Manhattanites throng to avant-garde opera, theatre, music and cinema at “BAM”, the Brooklyn Academy of Music. There are, indeed, few other places in America where one can hear a Swedish opera in Swedish. Some also make the pilgrimage to galleries and performances in the cobbled streets of Dumbo (Down Under the Manhattan Bridge Overpass), which estate agents are trying to dub the new East Village.

“Bridge and tunnel” used to be the Manhattanites' dismissive term for insufficiently stylish visitors to the island from further out. Now Brooklynites use the term too, and count themselves among the insiders.

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After the fall

Feb 17th 2005
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What September 11th did, and what it didn't

Getty Images

The shadow of death

NEW YORK has had intimations of mortality before. On June 15th 1904, the steamship *General Slocum* caught fire when taking the congregation of a German church in the Lower East Side on its annual picnic, and 1,021 people died. At the time, that was a higher proportion of the city's population than the number killed in the attacks on the World Trade Centre. Downtown "Kleindeutschland" (little Germany), a community of around 80,000, never recovered.

September 11th was very different in several ways. As an attack on America, it shook not only New Yorkers but Americans and the world. America's wars in Afghanistan and Iraq were direct results of it. Families from all over the region lost someone, and the funerals and memorial services went on for weeks. Many New Yorkers saw and heard their skyline's proudest highlight collapse. Even more smelled the shroud of dust and smoke long afterwards. About a quarter of the office space in lower Manhattan—the country's third-largest business district—was destroyed, and 23 buildings damaged.

Many more could easily have been killed. About 40,000 people normally worked in the twin towers, and around 150,000 visitors passed through the World Trade Centre complex each day. At the time the first plane struck, at 8.46am, the offices were not even half full. According to the National Institute of Standards and Technology, between 16,200 and 18,600 people were in the towers, and around 87% of them escaped. But every death was one too many. New Yorkers shared a wave of grief and felt connected. Just under a year later, an implausible 46% told pollsters that they personally knew someone who had been killed or hurt. As a result, folk wisdom has it, they got nicer.

The idea produces a derisive snort from Ray Kelly, the police commissioner. People becoming nicer to each other is not something he sees in his line of business. Less hard-bitten souls point to what happened on August 14th 2003, or rather what didn't. On that day a power failure blacked out New York for 25 hours, and the city coped easily and peacefully. There were fewer arrests than on a normal mid-week August evening. By contrast, in a shorter blackout in July 1977, New York had erupted in an orgy of looting and burning. The police say the difference is explained by better policing, not by September 11th. Perhaps. But conceivably 1977 was the aberration and New Yorkers have been mostly civilised for quite a while. The previous big blackout, in November 1965, was all candle-lit dinners too.

The owner of several of the city's most popular restaurants says that customers have become more mindful of their mortality since September 11th. They drink more, he reckons, and are going out in larger groups because they want to see more of their friends before the next disaster strikes. But other restaurateurs find nothing of the sort. It seems that every theory about how

September 11th changed New Yorkers has an equally plausible rebuttal. Even the economic impact of the attacks is uncertain.

Some things can be reckoned fairly straightforwardly. The clean-up took around $1.5 billion, and repairing damaged infrastructure will cost about $3.7 billion. Economists at New York's Federal Reserve put the lost lifetime earnings of those killed at $7.8 billion. Firms got $9.5 billion in insurance payments for interruptions to business. The cost of replacing destroyed buildings depends on how much gets rebuilt, and there are other imponderables. But the intriguing question is what happened to the city's prospects.

Incalculable

New York's long boom of the 1990s started to slow down in January 2001 and the city had begun to shed jobs that May. So it is hard to disentangle the effects of the attack from those of a recession that was already gathering pace and which it intensified. It is clear that most of a sudden plunge in New York's hotel, bar, restaurant and air-transport jobs in October 2001 can be blamed on the attacks. The same applies to over 17,000 jobs, mostly in finance, that moved across the Hudson to New Jersey in the following weeks (although most had returned to New York by the new year). According to an analysis of trends before September 11th by the New York office of the Bureau of Labour Statistics, the attacks were responsible for around 30% of the wages lost in New York in 2000-02.

A comparison of New York with broadly similar cities supports the idea that recession harmed its workers much more than did September 11th. In a study for the Russell Sage Foundation, a New York think-tank, Cordelia Reimers of the City University of New York found that in 2002 the household incomes of workers in New York declined by less than in the other cities she examined. As for the longer term, another study for the Russell Sage Foundation, by Andrew Haughwout of New York's Federal Reserve Bank, found little evidence that the attacks made the city a less desirable place to work or live.

But this does not mean that nothing is changing. In New York, it always is. Two years after the attacks, just over half the larger tenants of destroyed buildings had moved to midtown, about a quarter were back downtown and 15% had gone to New Jersey. Of those who eventually returned workers to New York, some firms, such as American Express, moved back almost all of them. Others are building back-up operations in Brooklyn or outside the city, dispersing their staff for “business-continuity reasons”—ie, in case of another attack. Morgan Stanley, an investment bank that had been the World Trade Centre's largest tenant, will move around 2,000 workers upstate to a back-up centre in Harrison, 23 miles (37km) from the city. Only one big employer left the city altogether after September 11th: Philip Morris, which puffed off to tobacco-friendly Virginia. But, jolted by the attacks, firms are reconsidering where their people should be, and how many they need.

The combined effects of September 11th and sluggish growth have underlined or accelerated job trends that were already under way. Firms had been drifting north from downtown for much of the past century, largely because of midtown's big rail terminals, Grand Central and Pennsylvania Station. The building of the World Trade Centre in the 1970s was an attempt to stem that flow, and the conversion of some downtown office space into homes in the 1990s was a bid to compensate for it.

Subsidies, tax-breaks and lower costs are luring some south: several midtown law firms have taken cheap space, and Morgan Stanley is planning to move about 1,400 workers from midtown to lower Manhattan. Downtown

Alamy

vacancy rates remain higher than midtown ones, and rents are much lower. That is likely to be a headache for Larry Silverstein, a developer who had leased the World Trade Centre from the Port Authority of New York and New Jersey just before the attacks, and is now busy filling the hole.

The Freedom Tower, an asymmetrical structure somewhat evoking the Statue of Liberty, is due to be completed on the site in 2008. There is no firm interest from any big tenants yet. Together with four smaller towers on the drawing board, the development aims to provide about 10m square feet of office space by 2015. The area is due to get a performing-arts centre, a cultural centre, a memorial site and a magnificent glass-domed transport hub. Several parks and lots of shops may be on the way too.

Still desirable

But although on the drawing board the office buildings look more fetching than the slabs of the World Trade Centre, they may well, like the original, be hard to fill for quite a while—if indeed they all go up. A study for the Lower Manhattan Development Corporation in 2002 estimated that it would be 2022, not 2015, before the market would support 10m square feet of new office space, and demand is returning more slowly than expected.

Employment in finance soars and plummets with the markets: in the boom of 1995-2000, the securities industry created nearly 34,000 new jobs in the city, then lost them all again over the next three years. But the long-term trend in New York is down. Since 1990 about a fifth of the city's finance jobs have gone. Consolidation in the industry, such as Bank of America's acquisition of Fleet, and J.P. Morgan Chase's acquisition of Bank One, tend to cause jobs in the city to disappear, especially when margins are tight.

New York's manufacturing industry, which consists largely of clothes-making and printing, continues its disappearing act. The city was once the largest manufacturing centre in America, with nearly 1m jobs in the sector in 1960, but in the past ten years the number has fallen by 45%. It still has its sweatshops in Manhattan's historic Garment District, just south of Times Square—now known as the Fashion District, to sound less industrial. But they are dwindling. The neighbourhood is gradually following the path pioneered in the 1960s and 1970s by SoHo, as workshops become studio offices and loft apartments.

The self-employed are largely left out of the payroll figures that make headlines

The city's service firms increasingly contract out what they can, to save payroll and occupancy costs. This plays to one of the city's strengths, namely self-employment, because plenty of “outsourced” jobs in fact stay in New York. A programmer, designer or fund manager can be fired one day and be back at work for himself the next week. Self-employment continues to grow fast in the city, and to take a bigger share of employment: according to the Commerce Department, it rose from 554,000 in 2000 to 656,000 in 2002 (the latest year for which figures are available). The self-employed are largely left out of the payroll figures that make headlines. New York is also reckoned to have about 400,000 “undocumented”—ie, illegal—immigrants, many of whom, no doubt, invisibly work for themselves.

New York's high costs put pressure on employers to move out any “back office” jobs. This is nothing new, but it is intensifying. Citigroup, for example, is planning to move some 1,000 employees from downtown Manhattan to New Jersey, though it says it will eventually add more high-paying jobs in the city. Higher insurance and security costs after September 11th have increased the incentive to move quieter jobs to greener pastures.

“Anyone who doesn't need to be here should get out,” says the chairman of a big investment bank from his Manhattan office. This is not a premonition of more terror, but part of a business plan. Deal-makers and those who need to meet clients work best where the clients and other deal-makers are, goes the theory. The rest should be put somewhere cheaper.

A liking for apple pie

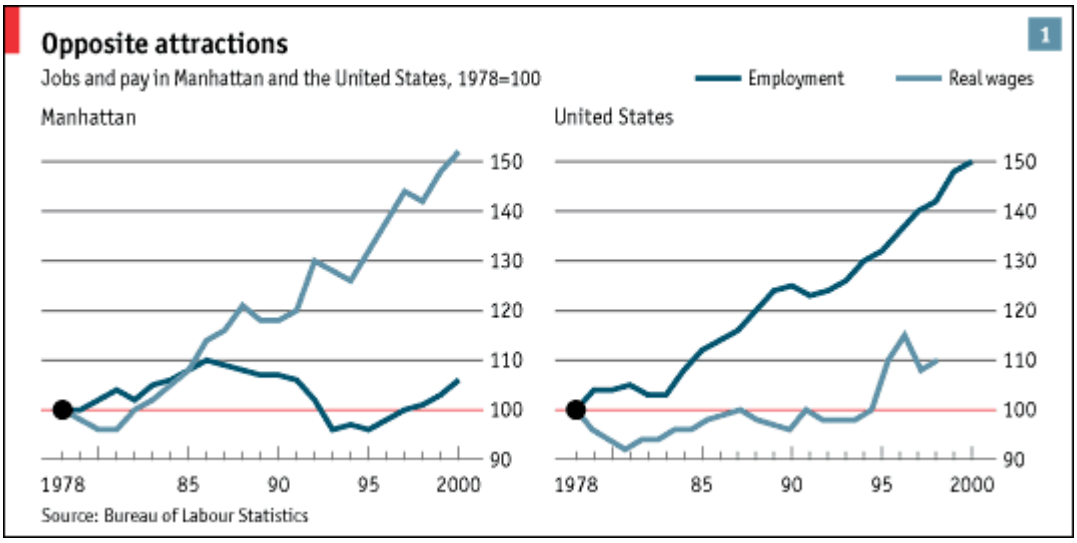
The idea applies as much to publishing as to finance: the publishers are here, so the agents are too, and authors can fit in a chat-show appearance and plenty of readings as they make their rounds. Marketers, advertisers and fashion designers like a large and diverse test-market, and fellow souls to swap ideas with. Lawyers, architects, accountants and all manner of consultants want to be where their clients are. A brief, a design or a report can be e-mailed from anywhere; but a handshake, a lunch and a look in the eye remain popular as foreplay. Doctors like large populations because they can find rare and interesting diseases lurking among them.

Ask the boss of a business that could be anywhere why it is in New York, and the answer is usually people. It is not only the plum jobs and the kaleidoscope of entertainments that bring a highly skilled and eager workforce to New York, but also the chance to find a different job if the first one doesn't work out. It is all very well to argue that telecommunications will eventually wipe out the advantages of agglomeration and let people scatter. In practice, though, when rival firms are down the street, it is easier to find and move to the next job.

When rival firms are down the street, it is easier to find and move to the next job

And when people are your main asset, it pays to be where they want to be. Why is Goldman Sachs, an investment bank, building a new headquarters downtown when it has a new building, just across the water in Jersey City, standing partly empty? A $1 billion cheap loan from the federal government may be one answer. More importantly, though, key traders refused to leave Manhattan. Some New Yorkers will pay a high price to stay, even if their jobs go. About 600 of the 4,000 employees at the offices in Stamford, Connecticut, of UBS, a big bank, reverse-commute by train from homes in New York even though they could save a tidy sum in taxes by living near their jobs.

Unusually, New York levies its own income tax on top of a high state income tax and federal tax. Its infamously high tax burden is often cited as a reason why it does not have more jobs. New York regularly comes way down the list in studies of good cities in which to build businesses and create employment. A report by the Milken Institute, a think-tank in Santa Monica, last November ranked the New York metropolitan area as 169th out of 200, just ahead of Kalamazoo.



But this neglects one central fact about New York's economy: that it is pretty much the reverse of the rest of America's. Just look at employment and real wages in Manhattan, where most of the city's jobs are, and in the United States as a whole over the past quarter-century or so (see chart 1). Although the city's employment is highly cyclical, the underlying level has remained much the same for decades, whereas real wages have grown strongly. America is the opposite: employment has grown, but average real wages have barely moved. Three decades ago, when there were more jobs in New York than there are now, income per head in Manhattan was twice the national average. By 2001 that multiple had risen to three times. New York has captured an increasing share of high-paying jobs by continually restructuring its economy to become ever more productive.

The city seems to be doing well at exploiting the advantages of density and providing opportunity. Inevitably it will create fewer jobs than less crowded places, because its borders are fixed and it has little room. And it can hardly avoid having plenty of poverty amongst the wealth, if only because it is so welcoming to immigrants who arrive precisely because they are poor. But none of this calls for complacency. It calls for good management.

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Under new management

Feb 17th 2005
From The Economist print edition

On balance, the mayor's political liabilities are assets for the city

Reuters

Bloomberg redraws the map

IT WAS an excruciating but also a heartening sight. At a community college in the Bronx on January 11th, Mike Bloomberg ambled awkwardly down to the stage, trying hard to remember whom to kiss, and delivered his fourth annual State of the City address. Cramming a stream of achievements, statistics and plans into a speech that went on for more than an hour, he repeatedly mangled his words. A verbatim transcript would not be pretty.

New York's 108th mayor is not a natural politician. The founder of a business-information and media firm, he financed his own $73m election campaign and runs the place like a benign and energetic CEO. In a notoriously patronage-infested city, he has no debts to unions, property developers or party bosses. A self-made billionaire several times over, he is far too rich to be bought. He is not interested in higher office, though he would like to be re-elected in November. A fellow billionaire says Mr Bloomberg needs his head examined for taking on the job.

The timing, certainly, was a challenge. The attacks on the World Trade Centre came during Mr Bloomberg's first election campaign, and he started in January 2002 with a huge fiscal gap to fill, thanks to the terrorists' work, the recession and an imprudent budget by his predecessor, Rudy Giuliani. Mr Giuliani's popularity had soared after his handling of the September 11th attacks. His approval rating among whites, already high, went up by 24 percentage points. Among Latinos and blacks, it roughly doubled. “America's mayor”, prevented by term limits from running again, was a hard act to follow.

Wisely, the new CEO of New York did not even try to play the usual role of larger-than-life mayor. Instead, he did some market research, recruited the best brains he could find—many from business, some from his own company—and set them to work on implementing a business plan for the city.

One of the most noticeable early steps was to introduce “311”—a form of centralised customer service for the city, modelled on the service that comes with the financial-data terminals which made his fortune. Rather than navigate dozens of obscure city agencies, about 40,000 New Yorkers a day now dial 311 to make complaints or ask for information or help. At the very least, they get the opportunity to sound off, and the city finds out what is not working. One of the loudest complaints, notes the mayor, is about noise. So the city's noise laws were rewritten, though the city council has yet to enact the changes. But perhaps the biggest part of the plan is barely noticeable at all, because it sounds so boring and moves so slowly.

When a workshop closes in the Garment District, there will often be a fight to prevent the space

being used for anything but another clothing factory, so it stays empty. Vast areas of the city are still “zoned” for uses that are long gone. A key part of the Bloomberg team's strategy has been to get zoning regulations altered so that homes and businesses can go up in the right places, and underused areas spring to life. Architects and planners say, hopefully, that Mr Bloomberg's main legacy to the city will be the revival of its underused waterfront. New York has had little long-term planning for some time. Mr Bloomberg's biggest ideas, if they work, will pay off mainly after he is gone. This is true of his school reforms too (see article).

On the waterfront

The largest plan is for Manhattan's last frontier, 360 dull acres bordering the Hudson river from west 30th to 42nd streets. This is aimed mostly at providing more office space and homes to meet demand in the 2020s and beyond. But the proposed first step, in partnership with the Jets football team, is to build a 75,000-seat sports and convention centre and extend a subway line out to it. At the moment, New York has to turn away many conventions because it does not have big enough meeting spaces. Mr Bloomberg is particularly keen on the idea because he thinks it will bring more visitors to New York, and tourism-related jobs provide work for unskilled immigrants. New Yorkers are unconvinced. To get the project moving, it is being tied to New York's bid for the 2012 Olympics. This is a long shot: Paris is the favourite, according to London's bookies. Ladbroke's puts New York at 14:1. The venue will be decided this July.

The stadium may fail, but at least Mr Bloomberg has some new ideas. A keystone of what used to pass for New York's economic strategy in recent decades was to give large tax breaks to employers to stop them leaving the city, which they often had no intention of doing anyway. Among those who have been offered bribes to stay have been the *New York Times* and the New York Stock Exchange. Mr Bloomberg has mostly stopped this “corporate welfare”, though much of it is in the hands of the state government, and there are fat federal loans for redevelopment after September 11th that cannot easily be used for anything else.

The main assets of New York's most valuable firms are their people, and Mr Bloomberg believes that on the whole those firms would not leave for cost reasons unless they are failing anyway. But demand for the city's homes is high too, so it is perhaps odd that he has not yet sought to reform the city's property tax. The rise in home values has long failed to be captured in tax assessments, and residential property is now clearly undertaxed in relation to the commercial sort.

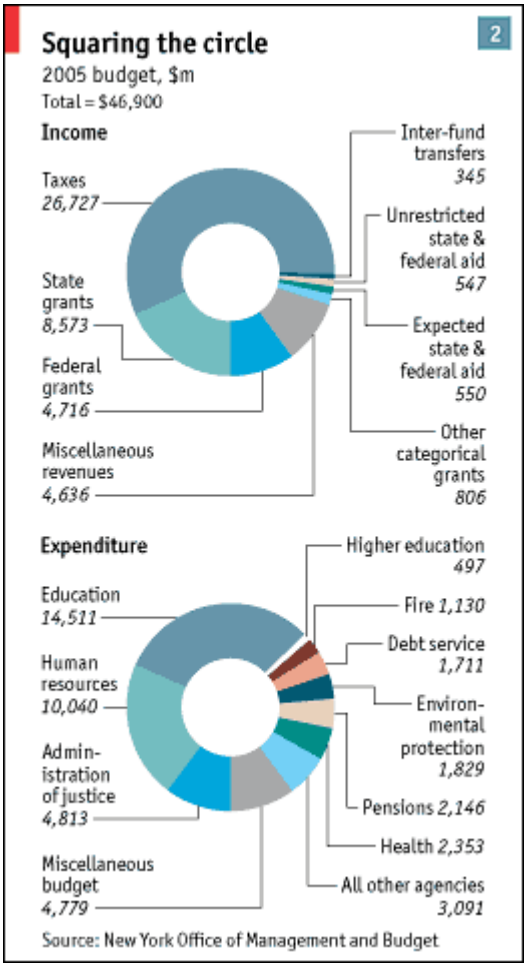
In the past fiscal year, according to the independent Citizens' Budget Commission, homes for one, two or three families made up half the market value of city properties, but their owners contributed only 14% of the total property-tax take. Commercial properties made up 26% of the value, but paid a 43% share of the tax. Instead of trying to make the distribution more equitable, Mr Bloomberg sent a $400 rebate to many home-owners last year to compensate for property-tax increases at the beginning of his term. He plans to do the same this year. But owners of commercial properties, who paid most of the increases, get nothing back.

Given its voracious appetite for public spending, the city badly needs more revenue from somewhere. According to an analysis of 27 American cities in 2001-02 by Andrew Haughwout and Nathaniel Hilger of New York's Federal Reserve, New York spends three times more per resident than the average city. In public welfare, the multiple is over 17 times and in education over six times.

A lot of this spending is out of the city's direct control, being mandated by the state government. The state's constitution requires “aid, care and support of the needy”, and the city is forbidden to cut education spending unless tax revenues plummet. Local boundaries make this tougher for New York than for other places in the state: the city's wealthy suburbs are in other counties and

therefore beyond the reach of its taxes.

Unusually, the city is obliged to pay a chunk of the costs of Medicaid, which provides health care for the poor. Elsewhere this is funded by the federal and state governments, but in New York the state fixes the level of benefit and the city picks up a quarter of the bill. Similarly, the pensions and fringe benefits of the city's municipal workforce are negotiated between unions and the state government in Albany, then paid by the city. Predictably, the pensions and benefits are generous.



All in all, according to the city's Office of Management and Budget, “non-discretionary” city spending is set to soar from $16 billion in 2004 to $22 billion in 2007, whereas spending by mayoral agencies stays essentially flat. The small silver lining to this cloud is that it puts pressure on the mayor to trim what he can. Mr Bloomberg has quietly eliminated some 18,000 municipal jobs, mostly by natural wastage, and seems to be doing more with less.

Fighting a Republicrat

In the election due in November, Mr Bloomberg will benefit not only from incumbency and from his own money, but also from the fact that his opponents cannot work out how to attack him. He is in truth a fairly liberal Democrat, who ran as a Republican merely to avoid a gruelling Democratic primary.

Some will try to play the revenge card: after the Republicans' victories in the White House and Congress last year, New Yorkers—who are overwhelmingly Democrats—will be invited to show their disapproval of Mr Bush by voting out the local Republican. The problem with this is Mr Bloomberg's evident lack of any Republican agenda. The most unpopular thing he has done was to raise taxes, and he does not want to privatise anything.

It will be said that he does not fight the city's corner against the state and federal governments. True, he does not kick and scream, as New York's mayors have often been expected to do. He prefers instead to work behind the scenes and through the courts, which may be at least as effective. He contributes personally to the campaigns of congressmen who can be useful to New York, and in May won a court ruling against the state's governor, George Pataki, which forces the state to repay $500m a year of the city's old debt.

It will also be said that he made the city more expensive and that, as a rich man, he is out of touch and doesn't care. His property- and tobacco-tax increases were the highest ever, and he raised various fees and fines. But New Yorkers know that times have been tough since September 11th, and rivals will have to come up with credible alternative plans for closing the city's budget gap. Gifford Miller, the city council's young speaker, and Fernando Ferrer, a former Bronx borough president, will stand for the Democratic nomination, and there will be others. The Democratic primary will do much of Mr Bloomberg's work for him as the would-be nominees tear each other apart.

A lot can still go wrong for the mayor. Failure to win the Olympics for New York would make the stadium plan look misguided. His school reforms can be shown in a bad light, especially when the teachers' union weighs in. And he has not yet won the city's heart. In a Marist poll in December, 53% of registered voters said it was time to elect someone else, and Mr Ferrer, who has run (unsuccessfully) for mayor twice before and is a familiar face, looked set to beat him by 12 points. But that was before campaigning began in earnest. Television ads should help to show that Mr Bloomberg has done more than just persecute smokers and lobby for a stadium. This will be money well spent. It would be a pity to give New York back to the politicians just yet.

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Graduating Harpo

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From The Economist print edition

The politics of education

Alamy

Hands up those who want change

“HOW I came to be educated, over the years, I don't exactly know. I only know that it didn't happen during my sojourn at New York City Public School No. 86.” Thus wrote Harpo Marx, who dropped out of school at the age of eight a century ago because Irish boys kept throwing him out of the window.

New York's public schools still have problems with discipline and a high drop-out rate. In 2001, only 38% of pupils graduated from high school in four years, compared with an average of 68% for the country as a whole. Probably no more than one in five emerges ready for college. Perhaps that is why nearly a third of the city's public-school teachers send their own children to private schools, according to a survey by the Thomas B. Fordham Institute in Washington, DC.

In 2001 Mr Bloomberg put education at the centre of his election campaign for mayor. He promised to reform the city's school system—in effect, to take on the schools just as Mr Giuliani had taken on crime. Bravely, he asked to be judged on his success at it. But that will not be easy, except for historians long hence. Joel Klein, a former head of the Department of Justice's antitrust division, whom Mr Bloomberg brought in to take charge of the schools in 2002, says that turning around the city's public education system will take ten years.

The mayor has certainly been busy. First he persuaded the state government to give him direct control of the school system and restructured it, abolishing a politicised board of education that was averse to change, and 32 ineffective and sometimes corrupt community school boards. That opened the way for the introduction of a city-wide maths and English curriculum. Eight-year-olds who are not ready to move up to the next class are no longer automatically promoted; next school year, the same will apply to ten-year-olds. A hundred new, smaller schools have been opened, and 95 more school buildings are planned. Some $60m has been raised from private donors for an

academy to train school principals. Bad principals have been sacked.

It is conceivable that some of the 80,000 teachers employed by the city deserve the same fate, though the majority do a good job in sometimes terrible conditions, with some of them buying school supplies out of their own pockets. But the teachers' union contract makes firing for incompetence virtually impossible. Mr Klein wants the 200-page contract drastically simplified, with fewer restrictive work rules, and less emphasis placed on seniority rather than merit. The union and the city have been locked in pay talks for nearly a year. With 1,350 schools and 1.1m pupils in the city's public-school system, critics are bound to come up with stories worse than Harpo's in time for the next election.

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Whitman's paradox

Feb 17th 2005
From The Economist print edition

New York is here to stay; New Yorkers aren't

NEW YORK'S greatest poet, Walt Whitman, could have been talking about his city when he wrote his best-known lines:

> Do I contradict myself?
> Very well then I contradict myself,
> (I am large, I contain multitudes.)

Alamy

Getting their turn

He was referring to the chaos of his own soul. But New York, too, is well supplied with contradictions.

Consider, first, the puzzle that the city seems to be a caring socialist republic of cut-throat capitalists. Its vast wealth is obvious, and comes not only from its high-earning workers, but also from the heirs and heiresses, the widows of rich industrialists, the celebrities and the tycoons who keep apartments on Park Avenue. It is famous for worshipping success, particularly if someone has achieved it on his own. Yet it is also wedded to high social spending, has a romantic attachment to powerful labour unions and does not seem to believe in free markets, at least when it comes to housing. Most New Yorkers rent their homes, and fewer than a third of all apartments are let at market rents. Over 1m apartments in the city are still covered by some form of rent control.

There are perhaps three main reasons why New Yorkers have strong social consciences. First, New York has managed to keep an unusually high proportion of its well-off people within the city rather than farmed out to suburbs. Crammed together in a walking city, rich and poor mix in the streets and cannot avoid each other.

Second, although the place is famous for business and finance, plenty of New Yorkers work in jobs that come with a built-in social conscience. Of the city's ten biggest private-sector employers, four are hospital groups and two are universities. Nearly 40% of jobs in Brooklyn are in health, education or social services. Add in the fast-growing arts, entertainment and recreation sector, the city's many charitable organisations, students and social workers, and you have a city in which plenty of people are not cut-throat at all.

Lastly, New York has always been a city of immigrants, with a long tradition of looking after the latest arrivals. The giant United Jewish Appeal Federation of New York, for example, which raised $203m for various causes last year, was set up at the beginning of the 20th century when a group of Jews got together to aid impoverished European immigrants. Giving a helping hand up seems to have got into the blood of the place.

The myth of the melting pot

Immigration and race provide the next contradiction. New York's proudest boast these days is that it celebrates all cultures and welcomes everyone. So it does, up to a point. The city's 18,000 restaurants serve pretty much every food eaten round the globe, and its residents speak every language under the sun—except, it sometimes seems, English (particularly when it comes to taxi drivers and deli assistants). True, London, Paris and Hong Kong are increasingly open too, but each of them has an ethnic group that is in the majority. New York now has none. Yet it is pretty much the most segregated city in America.

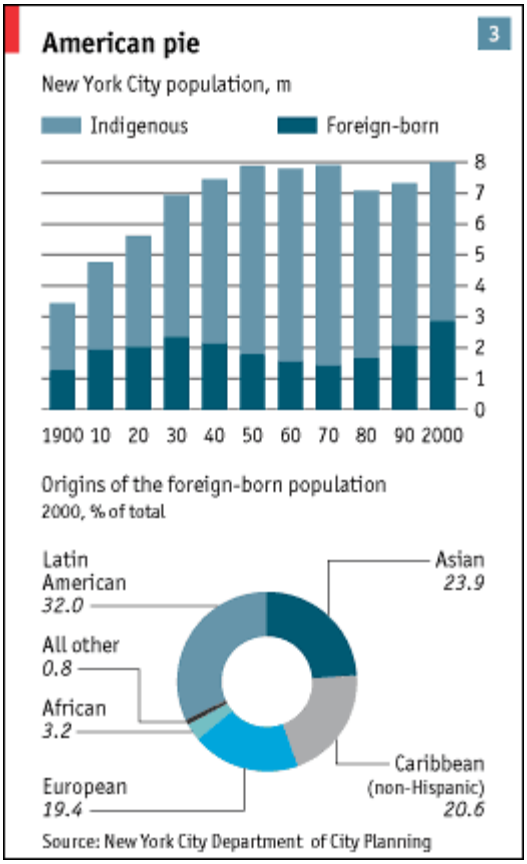
New Yorkers may tut about gated communities in California and Florida, but are their doormanned apartment buildings and rigorously selective co-operative boards all that different? According to the dissimilarity index used by the Lewis Mumford Centre at the State University of New York at Albany, New York has the highest segregation of blacks and whites among America's 100 largest cities, and the second highest segregation of Hispanic and non-Hispanic whites.

The centre also found that Asians and Hispanics are more segregated from non-Hispanic whites in New York's schools than in any other schools in the country, which can hardly be a good thing in itself. But New York's immigrants, especially those who have not mastered English, have always chosen to cluster together. Such cocooning eases their passage into a foreign world. For a recent arrival, the benefits of segregation are obvious.

Off the record, quite a few people worry that this new wave of immigrants is not like the last and will not assimilate so easily, or that it will change the city in some undefined but undesirable way. Yet that is a familiar tune. At the end of the 19th century, New York's old guard said that the city's Jewish immigrants could not learn and would get nowhere. And not so very long ago they maintained that Italians could not be educated either.

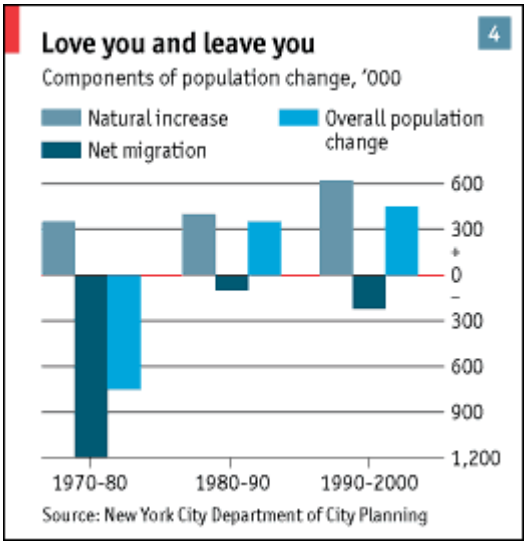
To see where some of the next high achievers will come from, look at Stuyvesant High School, one of New York's few public schools to select its pupils purely by examination. Last year it got more students into Harvard than any other school in America. Half its pupils are either immigrants or their children, with China, Russia and India the commonest countries of origin. Over half of its pupils are Asian.

There is something importantly different about today's wave of immigration, though, which is its diversity. This may well mean that it integrates better, not worse, than previous ones, because ethnic alliances are harder to form. Take Dominicans, the city's biggest group of new immigrants. They are mostly mulatto or black, so other Hispanic groups—who on census forms usually describe themselves as white—do not accept them as their own. Yet neither do African-Americans, because the Dominicans speak Spanish.



Such fragmentation certainly makes it harder for new groups to elect their own politicians. That was tough enough already. The state legislature has no term limits and ruthlessly gerrymanders its districts to keep the old guard in place. But change is coming, if very slowly. Last September Jimmy Meng, the owner of a lumber company in Flushing, narrowly managed to beat the incumbent, Barry Grodenchik, in a Democratic primary, and in November became the first Asian-American in New York's state assembly. If Fernando Ferrer, a Puerto Rican, wins the mayoral election this year, he will be the first Hispanic mayor of the city, and it will be said that the city's politics now reflects its latest arrivals. That would be true in a sense, because he would get the votes of newly arrived Hispanics, whose numbers are growing. But even he does not come from one of New York's new waves: the number of Puerto Ricans, like that of non-Hispanic whites and native-born blacks, is declining.

The revolving door



The most telling paradox about New York is that it is much less of a magnet than its boosters like to pretend. With a growing population and surging immigration, it would be natural to think that more people choose to come to New York than choose to leave it. Not so. For the past three decades, even in the booming 1990s, more people decided to move out (see chart 4), and the same seems to be true today. Were it not for the immigrants' high fertility, the city's population would be shrinking slightly. Thus on balance people seem to be voting against New York with their feet, but for it with their wombs.

People leave, and for as many reasons as they come. About half of the whites and Asians who leave the city stay in the New York region, moving to a greener space, a new job, or both. Many other Asians go to the west coast. Retiring whites tend to head to Florida. Blacks whose families moved up from the southern states in the first half of the 20th century are now drifting back south. Some of the many Puerto Ricans who arrived in the 1940s and 1950s are now retiring back to the island.

But to mourn the departures is to miss the point of the place. Imagine a school in which no pupil ever left, or in which the graduating class was less well educated than the incoming one. New York could not do its job of enrichment if it did not welcome plenty of people with little education and “issues with English”, as the current polite phrase has it, or if it did not send plenty of people away.

Dr Johnson famously said that when a man is tired of London, he is tired of life. Whether true or not for London, the same cannot be said of New York, because New York is larger than life. It is faster, busier, more enthralling and, for many, eventually too exhausting. That is fortunate for the city, as it makes room for the next new New Yorker ready to try his chance. Recall Walt Whitman again. He sang the praises of New York, “My city!”, as enthusiastically as anyone. Give me the streets of Manhattan, he wrote, “O such for me! O an intense life, full to repletion and varied!” And then he moved to New Jersey.

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Business schools

Bad for business?

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Getty Images

Business schools stand accused of being responsible for much that is wrong with corporate management today

THIS is the time of year when MBA students run not from classroom to classroom but from interview to interview as they try to get the high-paying job that they expect their qualification to deliver. It seems that the demand for MBAs is now strong again, after four decidedly weak years. “The big eaters of MBA talent have regained their hiring appetite,” says Ken Keeley, director of career opportunities at Carnegie Mellon's Tepper School of Business in Pittsburgh. At New York's Stern School, close to Wall Street, the number of jobs offered to this year's MBA class by the beginning of this month was double that at the same stage in 2004. Better still, average starting salaries in investment banking for Stern graduates were—at $95,000—up by $10,000 from a year ago.

But just as the market value of an MBA is reviving, its academic credibility is being attacked. In a forthcoming article to be published posthumously in *Academy of Management Learning & Education*, Sumantra Ghoshal argues that many of the “worst excesses of recent management practices have their roots in a set of ideas that have emerged from business-school academics over the last 30 years.”

Mr Ghoshal was just such an academic, a professor at London Business School until he died 11 months ago at the age of 55. He believed that the desire of business schools to make the study of business a science, “a kind of physics”, has led them increasingly to base their management theories on some of the more dismal assumptions and techniques developed by economists, particularly by the “Chicago School” and its intellectual leader, Milton Friedman. These include

supposedly simplistic models of individual human behaviour (rational, self-interested, utility-maximising *homo economicus*) and of corporate behaviour (the notion that the goal of a firm should be to maximise shareholder value). These assumptions, though in Mr Ghoshal's view badly flawed, were simple enough to allow business-school academics to develop grand theories of management supported by elegant mathematical models and empirical analysis that appeared scientific, and thus earned their subject academic respectability, but were, in fact, a pretence of knowledge where there was none.

Fight fiercely, Harvard

Mr Ghoshal's article is particularly critical of the management theories associated with two prominent Harvard Business School professors: Michael Jensen, whose development of agency theory has encouraged business schools to teach “our students that managers cannot be trusted to do their jobs”; and Michael Porter, whose “five forces framework” has been presented to “suggest that companies must compete not only with their competitors but also with their suppliers, customers, employees and regulators.”

A particularly worrying feature of these theories, says Mr Ghoshal, is that they have no “role for human intentionality or choice”. And not only do such theories falsely claim to be scientific, teaching them can make them self-fulfilling. Business-school students learn that managers cannot be trusted—so when they become managers their behaviour is of the untrustworthy sort. Students have been freed “from any sense of moral responsibility”. Hence scandals such as those at Enron, where business-school educated executives were prominent. And hence, perhaps, future Enrons yet to be created by this year's much-in-demand crop of MBAs.

Mr Ghoshal is not the only heavyweight academic to have come out with such a *mea culpa*. Jeffrey Pfeffer of Stanford University's Graduate School of Business, writes in the same journal that Mr Ghoshal “if anything understates the potential downside to the inculcation and acceptance of economic language, assumptions and theory.” In support he refers to a study in 2000 which found that a link between corporate size and the number of citations for violating health and safety regulations became stronger as the percentage of a firm's top managers holding an MBA rose. In a book published last year, “Managers not MBAs”, Henry Mintzberg, a Canadian business professor and a long-time critic of the degree, wrote that “the MBA trains the wrong people in the wrong ways with the wrong consequences”.

Not surprisingly, many business schools reject these claims. While Enron was well stuffed with MBAs and led by Jeffrey Skilling, a man who liked it to be known that he was near the top of his Harvard Business School MBA class, the clutch of top executives currently on trial for corporate corruption are notable for their lack of business-school qualifications. Richard Scrushy started life as a humble hospital worker. His trial on 58 charges of fraud involving billions of dollars when he was boss of HealthSouth, a health-care provider, is under way in Birmingham, Alabama. “He didn't have a CPA accounting degree or an MBA in business administration,” said his lawyer recently in mitigation. The jury has heard a tape on which Mr Scrushy says to some of his staff: “I'm gonna talk, talk to y'all just real. This conversation did not take place. OK?” followed by: “They ain't got nothing. They didn't ask me nothing about the numbers.” This is not the sort of strategy taught even in the best business schools.

Bernard Ebbers, the former chief executive of WorldCom, who is currently on trial in Manhattan on nine charges of massive fraud and is often described as “an ex-milkman”, has no formal business qualification. Dennis Kozlowski, the former boss of Tyco International, also currently on trial in New York on charges of fraud and grand larceny, would like to have an MBA. He once claimed one in his entry in “Who's Who in America”. But the truth is that he completed a few evening classes in business studies at Rivier College, a little-known Catholic school in Nashua, New Hampshire. He

did not stay long enough to collect a qualification.

It is also hard to square Mr Ghoshal's claim that recent scandals were the result of managers too eagerly trying to maximise shareholder value with the fact that shareholders have been some of the main victims of their actions. Nor for that matter is it true that everything taught in business schools is presented as scientific: Harvard's method of discussing corporate case studies, for example, is anything but scientific. And while there is some validity to criticisms of using simplistic economic assumptions—even the University of Chicago is losing its faith in *homo economicus*—it is easy to see why recent high-profile corporate-governance failures have mostly been viewed as evidence for, not against, agency theory.

Yet judged by their recent behaviour, at least, many business schools believe there is some validity to the criticisms levelled at them. Harvard and Stanford are among those to have introduced ethics classes into their MBA courses. At Tuck, a top-ranking school at Dartmouth College, MBA students are taught case studies of moral dilemmas by members of seven different faculties, including marketing, strategy and finance. In 2003, the Association to Advance Collegiate Schools of Business (AACSB), a standards-setting body which has all the top business schools among its 495 members, introduced new rules on teaching ethics in their curriculum. Some business-school academics want the AACSB to go further and make teaching a course on business ethics compulsory for accredited institutions.

Certainly, such efforts in the classroom may help business schools to repel the current attack on their reputation. This year's class of MBAs is coming from more ethics-conscious schools and, indeed, is being hired by more ethics-conscious businesses than any of its predecessors. But will that be enough to make firms, or their managers, more ethical?

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Pharmaceuticals

Safety first

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Pain relief for America's drug regulator

Get article background

THE past few months have not been easy for America's Food and Drug Administration (FDA).The worldwide withdrawal of Vioxx, a blockbuster anti-inflammatory drug, by Merck, its manufacturer, has left the FDA open to attack for doing too little, too late given mounting evidence that the product raises the risk of heart attacks. David Graham, one of its own officials, publicly accused the agency of being more interested in getting new drugs to market than scrutinising their safety after the fact. “The FDA has let the American people down and, sadly, betrayed a public trust,” he told Congress in November. The FDA—which this week has been holding a marathon advisory committee meeting on the risks and benefits of Vioxx and other COX-2 inhibitors—faces further scrutiny as various congressional committees take up the issue of drug safety.

Slowly, the Bush administration is responding to the criticism. On February 15th, Michael Leavitt, the new secretary of health and human services, announced the establishment of an “independent” Drug Safety Oversight Board within the FDA. This will routinely review emerging evidence about the safety of drugs that are already on the market, and make recommendations based on this information. It will also introduce new ways of communicating information about drug safety to the public. The board will bring together officials from the FDA's existing divisions in charge of new drug approvals and drug safety, plus some outside experts.

This is less than some politicians and public-health activists want: an entirely separate, and thus (they argue) truly independent, office of drug safety, well-funded and beyond the reach of the FDA's drug-approval branch (which they regard as too eager, and potentially tempted to downplay any evidence that its own approval decisions were mistaken). Others disagree. Pushing the FDA to weigh safety more heavily than benefit may already be a move too far, says Henry Miller, a former FDA official now at the Hoover Institution, a think-tank. Any slowdown in the approval of more innovative, but riskier, new medicines could, on balance, do Americans more harm than good, he claims.

The FDA this week also got (probably) a new head, albeit a familiar one: Lester Crawford, a former deputy commissioner and acting head of the agency since last year, has been nominated as the next permanent commissioner. He is likely to get the green light in Senate confirmation hearings. And he should be good news for the drug industry, says Rami Armon of Lehman Brothers, an investment bank. The industry wants a safe pair of hands to implement gradual reform of the FDA, not radical remodelling. But some observers fear that Mr Crawford, a veterinary expert, lacks the right experience or personality to handle negotiations with the big drug firms. “The FDA needs a firebrand, not a smouldering hulk,” says Mr Miller.

Communications

Telecomglomerate

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A new breed of telecoms firm emerges

THE telecoms business in America, as well as being built with wires and switches, has been based on imaginary divisions: between local and long-distance calls; wireless and wire-line; regional and national service; voice and internet. But recent deals by America's two biggest “Baby Bells” to buy long-distance operators have laid to rest this old, fictional industry structure. A new corporate beast is emerging: the telecomglomerate, competing across all categories of communications.

On February 14th, Verizon, a large regional telecoms operator, said that it would acquire MCI, a long-distance provider, for $6.7 billion. Provided the deal goes through—some MCI shareholders still prefer a higher bid by Qwest—the combined firm will have annual revenues of over $90 billion and 250,000 employees. Along with the agreement two weeks ago by SBC, another regional Bell company, to buy AT&T, it brings to a close America's long-distance phone industry.

The logic behind both deals is to enable the regional operators, which have near-monopolies on local calls in their area, to move into supplying communications services to businesses, a lucrative market. Yet the deals will ultimately mean much more. They will end the old non-aggression pact among regional operators to avoid competing in each other's territory. Competition will come—first for business and, later, for residential customers—not across copper wires, but from wireless and fibre lines for internet access.

Both Verizon and SBC will be new “oligopolies” able to offer the full gamut of communications services, says Raul Katz of Adventis, a telecoms consultancy. Eli Noam, the director of Columbia University's Institute for Tele-Information, calls the consolidation a natural evolution to achieve scale and diversify risk. “The telecom industry has moved from utility to volatility, and it is difficult to survive in the commodity part of the business,” he says.

Ironically, MCI was devoured by the very competition it instigated. Founded in 1963 as Microwave Communications Inc, it set up wireless towers for radio dispatchers, and eventually took on AT&T's monopoly in 1968. In its first years, the joke was that it had more lawyers than linemen; the firm even placed its headquarters one block from America's telecoms regulator. Its 1974 antitrust suit against AT&T culminated in the 1984 break-up of “Ma Bell”. MCI was bought by WorldCom in 1998 and disappeared, until its name was resurrected after WorldCom emerged from bankruptcy protection in 2004 following an $11 billion accounting scandal.

The sudden removal of America's long-distance companies by the regional operators poses new regulatory questions, just as America's politicians debate revising the nation's telecoms laws and a new chairman of the Federal Communications Commission (FCC) has to be appointed to replace the current boss, Michael Powell, who steps down in March. Together, it heralds a massive overhaul of America's telecoms regulatory landscape.

“The new FCC chairman either has a big eraser or a new pen—one or the other,” says Reed Hundt, the FCC chairman from 1993 to 1997. Whether there are fewer rules or more, however, the mergers are expected to be approved by regulators with conditions, such as to ensure transparency for internet pricing for businesses.

But the new telecoms war will be not just between the telecomglomerates, Verizon and SBC, and the remaining Baby Bells, but among cable firms, too. They are now offering phone and internet service, just as telecom firms are now vying to offer TV service. Battle lines are being drawn.

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General Motors and Fiat

Valentine's Day divorce

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Fiat and General Motors celebrate the end of an affair

FULL-PAGE adverts ran in Italian newspapers on February 15th, announcing the settlement of Fiat's dispute with General Motors (GM). The ads celebrated the return to purely Italian ownership of a great national asset and called for Italians to rally round and support it. Before the deal was done, Fiat Auto, the world's weakest volume carmaker, had owned a put option which could in theory have forced the American firm to buy it. In return for €1.55 billion ($2 billion) from GM, that option has been given up. GM also gave up its 10% stake in the Italian firm and agreed to scrap a joint-venture formed with Fiat to make engines and gearboxes.

Despite the joy professed by both firms, there does not really seem much to celebrate. In effect, Fiat has escaped from an industrial liaison that was supposed to be its salvation. The compensation, though higher than most industry observers expected GM to pay, amounts to only 18 months' outflow of cash from Fiat Auto. Since the alliance was formed five years ago, GM's European arm and Fiat have racked up huge losses. GM refused to put any more money into Fiat when asked to do so two years ago.

GM's spin doctors have hailed this week's deal as a great result for its shareholders. In return for over $4 billion (the original investment plus the exit fee), GM's boss, Rick Wagoner, points to cost savings resulting from the joint-venture worth $1 billion a year (mostly from joint purchasing contracts with Fiat) and to a half share in a diesel-engine factory in Poland. GM has also acquired important intellectual property rights in diesel technology, an area where it was weak. These gains will survive the end of the joint-venture.

Yet, in fact, the marriage proposal to Fiat was one of the daftest decisions made by GM in many a year. It agreed to the put option only because it was terrified that Fiat's controlling Agnelli family would engineer the sale of the firm to DaimlerChrysler instead, thereby crushing GM's Opel and Vauxhall brands. Ironically, given DaimlerChrysler's dismal record with other acquisitions, GM might actually have benefited from another Teutonic takeover.

Fiat, for its part, has bought some more time and the freedom to cast around for other help. One possibility is to float Ferrari, in which it holds a 56% stake, to raise more cash. Already Fiat has decided to take Maserati out of Ferrari and put it into Fiat Auto alongside Alfa Romeo: between them these premium brands, if managed properly (for a change), could help save Fiat Auto, though it still suffers from massive over-capacity in its plants.

Fiat's chief executive, Sergio Marchionne, has also talked about doing one-off joint-ventures with the likes of PSA Peugeot Citroën, with which it already shares a factory making vans and people carriers. But who would want to get more deeply involved with a firm as weak as Fiat? Chinese manufacturers (already picking at the scraps of MG Rover), desperate for engine technology and an entrée to Europe might be tempted. What would Fiat's ads hail then? The return of Marco Polo?

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Italian business

Bargain of the century

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How to double your money in Italian retailing

THERE are many ways of making money quickly in retailing. Philip Green, a British entrepreneur, took just two years to make a paper profit of £1 billion ($1.9 billion) by reviving BHS, a once-struggling British high-street chain. Another lucrative strategy is illustrated by the joint-venture between IFIL, a listed Italian investment company controlled by the Agnelli family (which also controls Fiat, Italy's largest industrial group), and Auchan, a private firm that is France's third-largest supermarket operator.

IFIL and Auchan are jointly breaking up La Rinascente, until two years ago a listed Italian retail firm. The process is nearly complete. This week, Lazards, an investment bank, opened bids for Grandi Magazzini and UPIM, La Rinascente's department-store chains. Analysts anticipate that the bids for the stores, whose value lies mainly in their property, will exceed €800m ($1.04 billion).

This money will be split between the two partners in the joint-venture that began in 1997. On completion of the sale of the department stores, IFIL will have turned its share of the joint-venture into cash—some €1.75 billion in total when other sales are also counted. Auchan has taken its share in a mixture of cash and assets. In March 2003, when IFIL and Auchan completed an offer for the 41% of La Rinascente's shares that they did not own, thereby delisting it, the implied value of the whole group was €1.77 billion. So IFIL and Auchan have doubled their money since taking La Rinascente private.

In 2003, La Rinascente's operating profit improved only modestly amid stiff competition. So how did IFIL and Auchan do it? The timing of their offer to La Rinascente's minority shareholders was certainly opportune: the price of the ordinary shares had slumped from an average of €5.90 in 2000 to €3.34 just before they made their offer which, at a 33% premium to that price, was accepted by most minority shareholders.

Offer documents sent to shareholders are supposed to contain sufficient information to allow a proper evaluation of the offer. In those sent to La Rinascente's shareholders, which were approved by Consob, Italy's stockmarket regulator, IFIL and Auchan did not hint at a break-up of the group. On the contrary, they talked of their own “implementation of medium-to long-term strategies” and of plans for La Rinascente to continue “in the various sectors in which [it] operates”. The joint-venture agreement would run until 2022 (though, from 2012, IFIL could force Auchan to buy it out).

Astonishingly, the offer documents contained no information about the market value of La Rinascente's extensive property portfolio. This portfolio, whose book value at historic cost was €1.27 billion, included plums such as 38 shopping centres (most with an Auchan hypermarket), shops in prime city-centre sites, and the valuable Rinascente building in the heart of Milan.

Yet just months after the offer was completed, the market value of the 38 shopping centres (alone) was established at €861m, following competitive bidding. An American property group was selected to buy 49% of a new La Rinascente subsidiary, Gallerie Commerciali Italia (GCI), to which the centres were sold. Following this deal La Rinascente in effect paid a special dividend worth nearly €300m each to IFIL and Auchan.

Late last year, Auchan agreed to pay €1.06 billion to IFIL to buy it out of La Rinascente's supermarket chains and of the controlling stake in GCI. This deal thus valued La Rinascente's food-retailing arm at €2.12 billion. Curiously, IFIL did not seek expert opinion on the appropriateness of the price for this, the most valuable part of the joint-venture. Nor did it invite competitive tenders—which might also have yielded a significantly higher price.

IFIL says that as La Rinascente is still pursuing its medium-term to long-term strategy, statements in the offer documents are consistent with the subsequent break-up. It adds that no valuation of the property assets was included in the offer documents because these contained public information only; and that there was no third-party involvement in the sale of the food business to Auchan because IFIL's board members felt confident about the terms of the deal. Consob, one of whose jobs is to ensure that investors are provided with meaningful information in offer documents, said that the relevant officials were too busy to respond to *The Economist's* questions.

Just under 1% of La Rinascente's shares remain in the hands of minority shareholders, who declined the opportunity to sell to IFIL and Auchan. These shareholders, too, have doubled their money. Asked who these shareholders are, IFIL replied: “We do not know.”

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Patents

Smart assets

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A successful strategy for intellectual property, now being pirated

PATENTS are proliferating, and ever profitable. Last year IBM was awarded 3,248 of them by America's patent office—a hefty 68% more than second-placed Matsushita. IBM has been top of the list for 12 years in a row, frequently winning over 50% more patents than its nearest rival.

Hot intellectual-property

Top US patent award recipients, 2004 (preliminary)

	Number of patents	2003 rank
IBM	3,248	1
Matsushita	1,934	4
Canon	1,805	2
HP	1,775	5
Micron Technology	1,760	6
Samsung	1,604	9
Intel	1,601	7
Hitachi	1,514	3
Toshiba	1,310	13
Sony	1,305	10

Source: US Patent and Trademark Office

In the past decade, Japan has regularly fielded the most firms in the annual top ten, and in 2004 boasted five companies among them. The only other country represented in the top ten is South Korea; Samsung first appeared in 1998, when the company began its transformation from a low-end, low-price manufacturer into a premium brand that competes on quality.

While the same Japanese companies have regularly featured in the top ten during the past decade, there has been more change on the American roster. Industrial stalwarts such as General Electric, Kodak and Motorola have given way to Micron Technology, Intel and HP—suggesting a certain fluidity of American R&D prowess.

The rankings shed light on both the past and the future of the technology industry. Generally it takes between three and five years to obtain a patent, so the 2004 crop reflects applications filed at the turn of the century. Patent protection lasts for 20 years from the filing date, giving successful applicants long-term exclusivity on their invention. Each of this year's leading patent winners has a backlog of over 1,000 applications at America's patent office.

IBM spends over $5 billion a year on R&D. It earns over $1.2 billion by licensing intellectual property (IP) protected by patents. “We built a model that lets us invest and identify ways to differentiate our products, and also to give others access to our technology. That lets us ensure we leverage the investment we make in R&D,” says Jim Stallings, IBM's vice-president of IP.

In January, IBM agreed to release 500 of its patents for use by open-source programmers, and Sun Microsystems freed more than 1,600 patents for open source, as well as its operating-system software, Solaris 10. The strategy is the opposite to that of Microsoft, which uses IP as a way to thwart competition from open-source software, such as the Linux operating system.

Ironically, for years Microsoft took no active interest in patenting its technologies, relying instead on much looser “trade secrets” protections. But that has recently changed. Bill Gates, the software

giant's chairman, says that obtaining patents is now a priority. The firm even hired Marshall Phelps, who masterminded IBM's patent strategy, to develop its licensing business. Microsoft in 2004 ranked around 30th, with roughly 650 patents.

“The move to license out our intellectual-property rights more broadly,” says Brad Smith, Microsoft's general counsel, is “a pillar” of the firm's future strategy. Microsoft spends around $6 billion a year on R&D and in 2004 it applied for more than 2,000 patents. This year it will apply for over 3,000, says Mr Smith—and it is expected to break into the top ten at last.

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Tecnovate eSolutions

The call of the East

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Is this what has become of the hippie trail?

IT IS a scene replicated in hundreds of huge offices across India: row upon row of young people behind flat-screen computer terminals talking to the other side of the world via their keyboards or telephone headsets. In the office of Tecnovate eSolutions in Delhi, the Swiss, Swedish, French, German and other flags give the décor an original touch. Even more unusual are the blond heads and Swiss, Swedish, French, German and other faces. Instead of simply moving jobs to India, Tecnovate has taken the next step: it imports some of the workers, paying them Indian wages.

Surely the whole point of outsourcing is that labour in places such as India costs a fraction of the wages paid in rich countries? Tecnovate has spotted that, for many young Europeans, a year or so in India seems attractive and even exciting. One-tenth of its 950 workers are Europeans.

The firm began in 2001 as the outsourced back-office of ebookers, a London-based online travel-agency with operations around Europe. Having cut costs in the British business, Prashant Sahni, Tecnovate's boss, wanted to expand across the Channel. But India lacked the language skills. When people had the languages, they were unqualified or unwilling to do the work. “The key was to hire foreigners,” says Mr Sahni. “The trick was how.”

The answer was for the European firms to recruit young people, whom Tecnovate takes onto its payroll, flies to India, lodges in a guest-house, trains and puts to work dealing remotely with their domestic markets. One young Swede with some travel-agency experience says she feels no worse-off than she did at home. A few of the foreigners later go back to work for ebookers at home. A few fall in love with India or an Indian and want to stay on. Some become homesick and quit. Some look on it as a “gap year” and go back to college.

But one year—Tecnovate's usual contract—is an age in India's outsourcing industry, plagued as it is by high rates of staff attrition. Tecnovate says its turnover rates are half the industry average of 35-40% a year. Mr Sahni says this is due in part to the foreigners, three-quarters of them young women, who make the place seem “cool”.

His next trick is to expand the business outside ebookers, still its main shareholder and the source of 90% of its business. Tecnovate already has four other clients. Other Indian firms are intrigued. Most of the successful ones have their hands full gearing up to meet demand from American and British clients. But one day, they too might want to tackle the non-English-speaking world, and offer young Europeans a latter-day passage to India.

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Icelandic businessmen abroad

Small country, big ambitions

Feb 17th 2005
From The Economist print edition

Icelandic businesses are making big acquisitions across Europe

THEY are well-heeled, these Icelanders. Brave, too. Last year's flow of Icelandic takeovers in Europe looks ready to become a flood—not all of it into companies much fancied by other investors.

Bravest of Iceland's brave is the Baugur Group, run by Jon Asgeir Johannesson. Born as a supermarket but now an investment house in retailing of many sorts, last autumn it bought Magasin du Nord, a Danish department-store group which, after three years of losses, expects to lose $30m more in 2004-05, on turnover of about $350m. Last week, a Baugur-led consortium completed the $1.25 billion takeover of Britain's Big Food Group, which had begun losing money on sales of some $9 billion. On February 9th, another struggling British supermarket chain, Somerfield, revealed it was a target. A bid is only a possibility, but could exceed $1.9 billion. Baugur had already bought British real estate, besides clothing and jewellery stores, and London's famous toy-shop, Hamleys.

Among other Icelandic buys, in December SIF, a seafood group, bought Labeyrie, a French food firm, for $675m (debt included); Bakkavor, a supplier of chilled meals, has bought 20% of Geest, a large British firm in that line, and is now studying a full bid; Icelandair holds 10% of Britain's low-cost airline easyJet. Actavis, a maker of generic drugs chaired by Thor Bjorgolfsson, who made his first pile in Russian brewing, has bought drugmakers in Bulgaria, Serbia and Turkey, and is now buying into India, as a road into the American market. Only 4% of its $500m-or-so turnover today comes from Iceland.

The Icelandic banks helping to finance these acquisitions are themselves buyers. The biggest purchase so far came last year from Kaupthing Bank, Iceland's largest. After earlier lesser but sizeable buys in Finland, Norway, Sweden and Switzerland, it paid $1.25 billion for FI-Holding, a Danish bank strong in corporate lending. In Britain, by early 2004 it held 19.5% of Singer & Friedlander, an investment bank. Burdaras, an Icelandic investment company, later bought a 9.5% stake, and many expect a full Icelandic bid for the London bank, now valued in the market at $950m.

Burdaras itself is 50.2%-owned by three arms of Landsbanki, Iceland's number two, which has overseas ambitions of its own. Formerly state-owned, Landsbanki was privatised in 1998-2003. In 2000 it bought Heritable Bank, a small British housing-finance bank, and in 2003 a private-banking operation in Luxembourg. It has just agreed to buy one of Britain's few surviving independent stockbrokers.

All this from an island of only 300,000 people. Not all the money is Icelandic: SIF, for instance, paid for Labeyrie partly via a syndicated loan in London. Yet it raised $300m, mainly from local sources, in a later share issue; and this soon after a Kaupthing issue had raised $550m. What is

the source of Iceland's financial muscle?

A broad answer is almost 14 years of deregulating and privatising government. Specifically, Iceland, like Luxembourg or Ireland, has become a friendly place for financiers and, like Switzerland, is not subject to EU tax-prying: Burdaras's biggest shareholder is Landsbanki's Luxembourg private bank. And corporate profits, taxed at 50% in 1991, and, after cuts, still at 30% in 2001, now pay 18%, the lowest tax-rate in the OECD after Ireland and Hungary.

Few as they are, Icelanders are also feeling richer. After a slide in 2001-02, the economy is back to 4-6% growth. And, with inflation and interest rates mostly low, house prices, bonds and equities have soared in recent years, encouraging a sharp rise in household borrowing. Some of this has gone, indirectly, into investment overseas. Local banks meanwhile have borrowed heavily abroad; an OECD estimate out this week suggests that the country's external debt may have risen by some $6 billion in 2004. A chunk of this has flowed out again into the overseas-investment spree. After all, there are not a lot of attractive opportunities for Iceland's ambitious businessmen at home.

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Face value

A new king for the Magic Kingdom

Feb 17th 2005
From The Economist print edition

Will Bob Iger be the next boss of Disney?

AP

Get article background

BETWEEN now and June, some of the world's leading media executives will compete for one of their industry's most sought-after jobs: chief executive of the Walt Disney Company. Michael Eisner, who has held the job since 1984, is to step down next year, and Disney's board has promised to name his successor this summer. At the moment the leading candidate—backed by Mr Eisner—is Bob Iger, Disney's president and chief operating officer, and Mr Eisner's number two, for the past four years.

At last year's annual meeting, 45% of shareholders withheld their vote for Mr Eisner's re-election to the board—a remarkable act of shareholder protest. Soon afterwards he gave up his title of chairman and agreed to step down as chief executive in September 2006. This year's annual meeting, held last week in Minneapolis, was a quiet affair, and Mr Iger took the opportunity to show himself off as a potential successor. Compared with Mr Eisner, he is pleasant and easy to get on with (though who isn't?). Institutional shareholders and analysts on Wall Street seem increasingly convinced that he could do the job.

And the timing of the succession is working in Mr Iger's favour. Lately Disney has improved its financial performance. Investors are feeling better about the firm: its shares have doubled from a low in 2002, and last year they outperformed the Dow Jones US media index by 18 percentage points. Mr Iger has been in charge of trying to revive Disney's ABC television network, which has

been losing money for a few years. So his candidacy for the top job has received a boost from the fact that ABC has produced not one, but two, hit shows—“Lost” and “Desperate Housewives”—and is rising in the ratings. People in the business know that two people fired by Disney last year (Lloyd Braun and Susan Lyne) were chiefly responsible for the two shows. Even so, the success is rubbing off on Mr Iger.

Yet the spotlight now on him is revealing some potential problems, too. A book published last week, “DisneyWar”, by James Stewart, paints an unflattering portrait of Mr Eisner and his second-in-command. In particular, the book chronicles instances where Mr Eisner questioned Mr Iger's abilities, including an incident where he allegedly told board members that “Bob can't run this company”. Mr Eisner claims he was misinterpreted. In one sense, any such conflicts between the two men ought to reassure critics such as Roy Disney, nephew of Walt Disney, who suspect that Mr Iger is nothing more than Mr Eisner's placeman. But such comments from his principal backer hardly inspire confidence in Mr Iger's ability to restore Disney's creative energy. The company says that “DisneyWar” is a “one-sided depiction of past events largely told through the eyes of those with a clear bias and personal agendas”.

According to one person who knows the board's thinking, “DisneyWar” contains another episode that directors will discuss before choosing a chief executive. In 2001 Disney bought the Fox Family Channel for $5.2 billion—and, according to the media-industry consensus, overpaid by $1 billion. In 2002, claims the book, Mr Iger intervened when Angela Shapiro—a Disney executive who had been given responsibility for the channel—produced growth targets for the business for a board meeting that were far lower than those used to justify the price of the acquisition. Ms Shapiro objected, but Mr Iger insisted that she rework the numbers. According to the book, Mr Iger confirms that he intervened, but says that he did so in order to produce better and more accurate results.

Supporters of Mr Iger say that his behaviour would be very different as chief executive than it has been as Mr Eisner's loyal number two. Might he usher in big changes? He will certainly be aware that his boss's habit of micro-managing people has led to an exodus of valuable management talent from Disney. As chief executive he could decide to give his executives more space. Another desirable change, some former executives say, would be to scrap Disney's feared strategic planning department, which some nickname the “department of business prevention” because of the way it vetoes new initiatives and deals that it has not conceived itself.

As for Disney's wider strategy, Mr Iger says that the firm should expand its international presence and concentrate more on new technology. He wants half of Disney's revenue to come from outside America, up from just under one-quarter now.

A topic of particular interest for rival media executives is how Mr Iger would handle his predecessor once selected to be chief executive. Would he be ruthless enough to insist that Mr Eisner get out of the way before his contract ends in 2006? Another scenario would be for him to reward Mr Eisner for his support by inviting him to stay on at Disney beyond 2006. That could work against Disney in at least one sense, however, as Mr Eisner has made an enemy of Steve Jobs, chief executive of Pixar, an animation studio that made some of Disney's biggest recent movie hits, such as “Finding Nemo”. Mr Jobs is likelier to mend relations with Disney if Mr Eisner has left.

Who's the leader of the club?

This week, Disney's executive-search firm is expected to start contacting top executives at other companies. There is no shortage of attractive outside candidates with the experience necessary to run Disney: Peter Chernin, the chief operating officer of News Corporation; Jeff Bewkes, chairman

of the entertainment and networks group at Time Warner; Les Moonves, co-chief operating officer at Viacom; or even Meg Whitman, chief executive of eBay. But some of them suspect that the job is already destined for Mr Iger, and are wary of risking their reputations, and current jobs, by submitting themselves for interview by the board if rejection is certain. The onus is now on Disney's directors to make it clear that the selection process is not a sham.

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Hedge funds

The new money men

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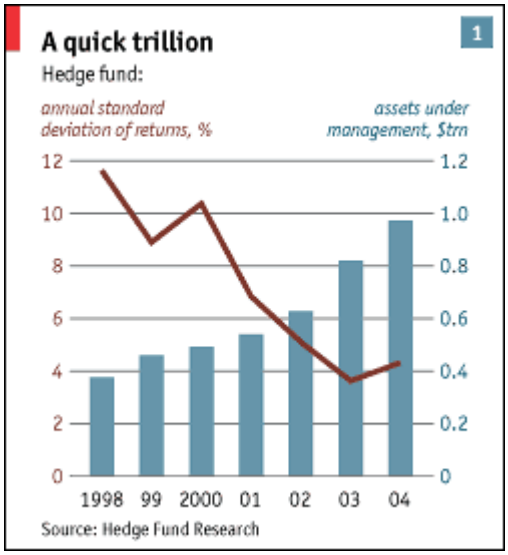
Investors have made a trillion-dollar bet that hedge funds will bring them rich returns. But will they?

Get article background

IT SEEMS an unlikely trend. In recent years the fund-management industry has been mauled for its excessive and opaque fees, deceptive marketing and rampant conflicts of interest. At the same time, however, not only has the industry flourished, but it has done so in its costliest, highest-leveraged and least transparent segment: hedge funds. Instead of shunning such unregulated funds, investors have been falling over themselves to grab a piece of the action.

Whereas the size of the mutual-fund industry in terms of assets and offerings has merely returned to its level of 2000, hedge funds have doubled in size and number, according to Hedge Fund Research, a consultancy (see chart 1). In 2004 alone around 400 new hedge funds were created, bringing the known total (many others escape scrutiny) of 7,000 into rough parity with the number of mutual funds.



The start-up fever is especially acute in the many hedge-villes dotting Greenwich, Darien, Rowayton and other lovely, affluent towns in southern Connecticut. New funds begin daily, some in spare rooms in someone's home, others in waterfront offices with parking for yachts. In Manhattan, midtown office towers serve as hedge-fund warehouses. Tiny windowless offices house unknown operators trying to build a track record. Full-floor suites

filled with lavish artwork, gyms and kitchens that bubble over with superb (and healthy) food are the domain of successful funds. The same is true in Boston, San Francisco and London.

While there have been numerous pronouncements that the tide will soon turn, nothing suggests this is imminent. Quite the opposite. Initially sold only to wealthy individuals, then the family offices of wealthy individuals, increasingly hedge funds are now being sought out by large institutions. Foundations and endowments, the least regulated component of the institutional world, came first; company and public pensions are now piling in. The State of New York announced in January that it might put some of its $88 billion pension fund into hedge funds, joining those managing the pension funds of teachers in Texas and Ohio as well as public employees in Chicago and California. If institutions merely meet the amount they currently intend to invest in hedge funds, another $250 billion will be flowing into the industry, according to Greenwich Associates, a consultancy.

What might hold them back is not desire, but capacity. Such is the popularity of hedge funds that many of the largest are closed or, as they say in the trade, “soft-closed”, meaning that entry requires special pleading—and many plead. Caxton Associates, Moore Capital, Renaissance Technologies, SAC Capital Advisors, Maverick Capital, and Highbridge Capital Management, all carrying excellent records and managing billions of dollars, are considered too inaccessible to be included in a Standard & Poor's index of investible funds. Unable to get into established winners, investors are pouring money into managers with no track record but good pedigrees. Last November, Eric Mindich, formerly of Goldman Sachs, raised $3 billion for a new fund. His old partner, Dinakar Singh, will open an equally big fund this month. It is widely believed that either one could have raised two or three times as much money.

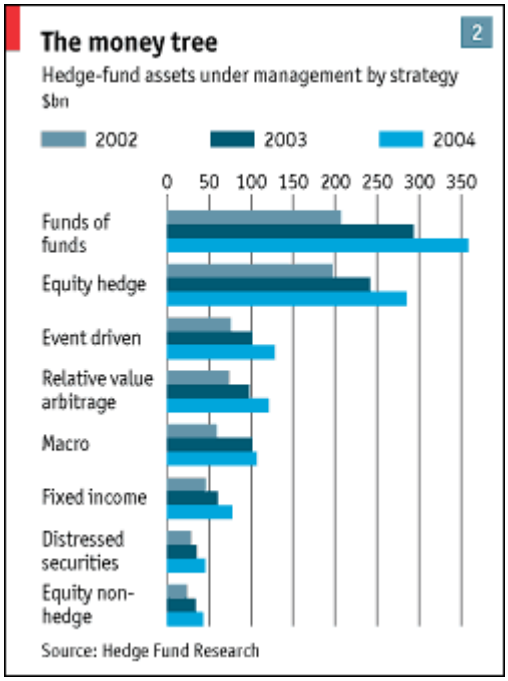
Given the enthusiasm, at the very least it should be clear what all these customers are buying. In fact, that is a surprisingly hard question. Unlike mutual funds, which are strictly defined under America's 1940 Investment Act, hedge funds operate under exemptions to the law. Theoretically that limits their audience to sophisticated and affluent investors. In reality, clever lawyers, lots of money and astute marketing have expanded the exemption so that they can be sold to anyone, do almost anything and keep whatever they do, and who they do it for, a secret.

Some hedge funds actually hedge, meaning they attempt to invest in a manner that offsets adverse market movements. But since they also want to capture returns, the hedge is never complete and many funds do not even bother (see chart 2). Responding to institutional demand, notes Greenwich Associates, some new hedge funds restrict themselves to holding long positions in common stocks, just like ordinary mutual funds or, for that matter, traditional accounts managed by brokers on behalf of clients.

Hedge funds have some common characteristics. They are usually pooled investments (like mutual funds) structured as private partnerships (unlike mutual funds). Many carry substantial leverage and are quite rigid about the flow of money from clients. Initial “lock-ups” for as long as four or five years are not uncommon; rarely is money allowed to come in or go out more than monthly. This restriction allows hedge funds to take positions in the most illiquid corners of the market including options, futures, derivatives, and unusually structured securities.

Where's the money?

Increasingly, the large funds that have succeeded flit from one area to another. Last year and the year before, when lots of companies were coming out of bankruptcy and the economy was improving, successful funds dominated the market for distressed debt. Since hedge funds can account for more than half the daily volume on the New York Stock Exchange and can have an equally large presence in every other financial market, where they might be today is anyone's guess.



Investors value this ability to embrace opportunities, magnify returns through leverage, and take difficult positions because of a stable base of assets. But they have not always been so keen. Mutual funds, if structured correctly, can have the same characteristics (though there are some liquidity restrictions). A big reason why mutual funds approach investing differently is that when they tried to take a flexible approach in the mid-1990s they were torn apart by consultants and customers for so-called “style drift”. Complaints reached a crescendo in 1996 when Jeffrey Vinik was hounded out of running what was then the single largest fund, Fidelity's Magellan, for moving from stock to bonds just a bit before the investment cycle turned.

Under pressure from the press and pension consultants, most (but not all) mutual funds began to follow narrow pre-designated benchmarks that were tightly limited to a class of investing, such as shares of companies included in the S&P 500 index, or an even narrower subset, for example a mid-cap benchmark. That helped performance in the soaring equity markets at the end of the last decade, but also contributed to their wretched results during the bear market of 2000 to 2002. It also undermined mutual-fund fee structures. Customers realised that much of the funds' performance simply mimicked the relevant index. Many chose to invest in index funds instead, because these charge far smaller management fees. (Perhaps appropriately, Mr Vinik, who has been something of a genius in identifying trends, reincarnated himself as an outstanding hedge-fund manager.)

The bear market prompted many investors to think it might be good to have money with an investment manager who knows when to invest and, ideally, where to invest, and works within a format that allows him to do so. Relatively good returns, meaning better performance than the market, has become a bit less important than absolute returns (ie, not losing money, especially when the market falls). Mr Vinik's move into bonds would now be considered within the context of astute risk control. Institutions aspire to hire managers who can provide high “alpha”, meaning risk-adjusted returns. But it may amount to much the same thing—making money and not losing it.

A clever mutual-fund manager could, of course, pursue this approach in the new environment. But it has become much more sensible to start a hedge fund. Why? Because, to cite a phrase of the moment, a hedge fund is “a compensation scheme masquerading as an asset class”. Whereas the average mutual fund charges 1% or 2% of assets, and smart buyers can pay a fraction of that, hedge funds charge 1% or 2% plus a big slug of profits, typically 20%, but often more. One well-known, but secretive, fund based on Long Island is reputed to charge 5% of assets plus 44% of profits. Another leading fund charges no maintenance fee but 50% of profits. An industry consultant says he has seen a new fund that will receive 80% of any excess above a guaranteed return linked to a well-known index. Even these huge costs do not really reflect what investors pay, since most hedge funds agree to conduct business through a prime broker, which extracts fees through stock- and bond-lending charges, as well as trading costs based on the fund's net

asset value.

The benefits of this kind of relationship for a manager and for the Wall Street firms are obvious. In a report published in 2003, Bernstein Research reckoned that the size of the hedge-fund industry was one-sixth that of the mutual-fund industry, but already provided more revenues. If true, the situation is now even more dramatic. People attracted to the idea of working in the investment world for the money (a sizeable percentage) cannot shift into hedge funds fast enough. Nor can the investment banks, which are losing good employees but enjoy the solace that many become exceedingly good customers.

To bank or to hedge?

Institutional Investor's obsessively read list of most-highly-paid hedge-fund managers starts with familiar names (George Soros: $750m), but 16 others made at least $100m in 2003. As impressive as the earnings are at the top, they are even more striking viewed from the bottom. Business-school graduates note that a job at investment banks often lasts only until the first bump in the market. Salaries are high, but pressure from those above you is higher still and there is constant carping about costs. A bad year at a hedge fund may result in unemployment, but a good year means good compensation amid excellent resources: costly data terminals and abundant creature comforts, such as fresh fruit, flowers and parties.

Banks might gripe about these comparisons were they not battling so hard for hedge-fund business. At a time when mutual and pension funds have become ever more reluctant to pay the traditional five cents a share for trades, hedge funds pay up to four times that amount if in the process they can receive good ideas or particularly effective execution. This makes sense because the hedge fund's compensation is tied to outperformance, not efficiency.

And trading is just the beginning for banks. Hedge funds want hot issues, structured derivatives, margin, stock-lending for short sales and the equivalent for fixed-income, clearing and settlement, customer support and marketing. The money coming from all these transactions and fees is enormous. Svilen Ivanov of the Boston Consulting Group reckons hedge funds received $45 billion in revenues last year, of which one-third to half was profits. Although there is some overlap in the numbers, investment banks collected $15 billion either directly from hedge funds or because of them, producing $6 billion in profits. For individual firms, hedge funds were critical to last year's performance. They produced one-quarter of Goldman Sachs's profits, estimates Guy Moszkowski of Merrill Lynch, and only a slightly smaller slug of Morgan Stanley's returns.

Performing for whom?

Oddly, given the spectacular wealth that hedge funds produce for their own managers and for investment firms, they do not, overall, seem to produce much wealth for clients. Certainly the highest-performing funds have produced breathtaking returns. Renaissance has earned almost 40% annually for more than a decade, SAC in excess of 30%. There are many others with excellent records. But there are good reasons to believe that these are rare exceptions. Whatever the merits of high fees—the ability to attract talent, a performance-oriented incentive structure that discourages bloat—they are almost certainly exceeded by the problems.

The most evident is the drag which high fees put on performance. Historically, an investor able to outperform the broad market by two percentage points annually has been considered something of a genius. But that barely covers the maintenance of the average hedge fund. High fees tied to performance also encourage hedge funds to take big risks. Winners might just be lucky and their

luck may be offset by the losses of others. A third problem caused by high fees is attrition. Successful managers become rich, possibly too rich to care about work, in just a few years. Managers that disappoint are quickly put out of business by angry clients, or they may shut down voluntarily because earning a performance bonus will require catching up to a prior "high-water mark" first. Last year around 270 funds closed. The available information on hedge funds suggests they typically last only a few years.

That adds complexity to the task of selecting a fund that will do well in the future. It also plays havoc with any indices used to track hedge-fund performance. A paper* published last November by Burton Malkiel, a professor at Princeton, and Atanu Saha, of the Analysis Group, a consultancy, presents a frightening picture of what is left out of the most commonly cited benchmarks. Hedge funds report their performance only when they want to, and consequently stop reporting in the months that they are collapsing. Unsuccessful hedge funds may never report. Clever hedge-fund organisers may seed many funds, operate them for a few years, then announce in public only the most successful ones, "backfilling" the performance data from prior periods—ie, projecting what the fund might have earned before it existed if it had pursued the same strategy. Worst of all, bad funds tend to disappear along with their records. Only one-quarter of the 600 funds that reported data in 1996 still exist. Recalculating results, Mr Malkiel concludes that for all their vaunted talent, hedge funds perform less well than cheaper mutual funds.

A second paper, in the *Journal of Investment Management***, concludes that, because of their double fee structure, hedge funds of funds (ie, funds that buy into dozens of other hedge funds, following the "fund of funds" approach that has become common in the private-equity market) perform worse than individual hedge funds. Yet such funds have become popular, especially with investment consultants, because they are seen as diversifying risk.

And even this somewhat patchy record may overstate the potential for hedge-fund success. Hedge-fund returns, relative to market returns, have been fading. This may be true for a number of reasons, including low interest rates (hedge funds often hold big cash balances while they wait for bright ideas); the result of so many hedge funds getting into the business and, often, pursuing the same strategies; the possibility that the supply of hedge funds has outstripped the talent to run them; or simple chance. "Why should the appeal of rich fees be limited to smart managers?" asks Howard Marks of Oaktree Management, a hedge-fund adviser in Los Angeles.

Nor do hedge funds represent a fresh start for their scandal-tainted industry. A small fund named Canary Capital was at the heart of the late-trading, market-timing scandal. Other funds have been prosecuted for allocating fees to brokers who never executed trades; violating fiduciary obligations by shifting good investments to personal accounts; and using funds for personal expenses. All of these are hard for outsiders to detect.

Dog for sale, $10m

The largest area of transgression, and one that is almost certain to arise more in the future, is the incorrect valuation of securities held in funds. All securities are, to some degree, hard to price. The less liquid they are, the harder this becomes and hedge funds specialise in illiquid securities. Even if a hedge fund wants to value its portfolio correctly, it could make mistakes. If it had other motives—and because compensation is a multiple of returns this cannot be ruled out—disaster could follow.

The SEC has brought 51 cases (11% of all its enforcement actions) against hedge funds, claiming damages in excess of $1 billion. Known prosecutions, as well as others that have yet to be disclosed, encompass around 400 funds. In only three of these cases were investors made whole, a result the SEC blames in part on the fact that it is able to investigate a fund only in response to

receipt of a complaint.

That is due to change next year. Last December, William Donaldson, chairman of the SEC, pushed through new regulations for hedge funds. Funds will have to register, meaning they will have to acknowledge their existence and submit to inspection by the SEC of their books and records. It would be no surprise if a series of announcements were to follow about hedge funds repricing their assets downwards and also, perhaps, reviewing how much they charge for compensation (the details of performance bonuses are complex and there is an assumption that they are mostly resolved in favour of managers).

Whether the new rules will act as a deterrent to abuses by managers or, more importantly, whether they will do anything to slow the industry's momentum remains to be seen. The bigger it grows, the more the boundaries between hedge funds and traditional asset management are blurring. But on current trends, hedge funds' second trillion dollars of assets will arrive even faster than the first.

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* "Hedge funds: Risk and Return". Working paper.

** "Fees on Fees in Funds of Funds" by Stephen J. Brown, William N. Goetzmann and Bing Liang.

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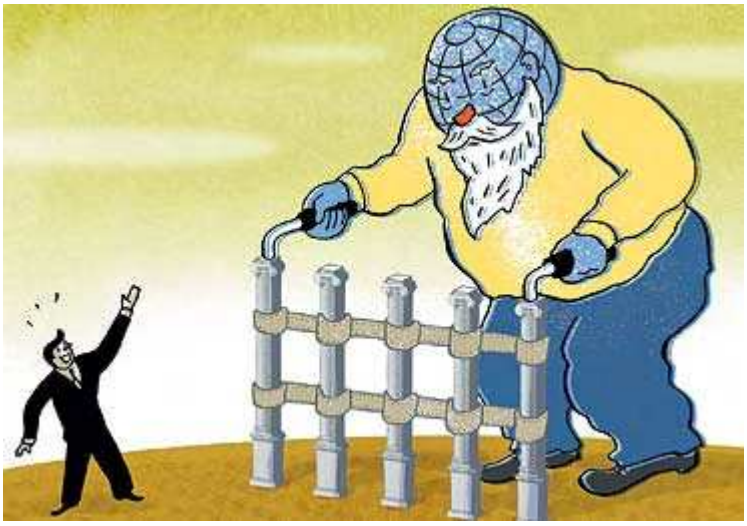
Pension reform

Second thoughts on the third age

Feb 17th 2005
From The Economist print edition



The World Bank reconsiders its pension strategy

Get article background

AROUND the world, rich countries are reforming their pension systems in preparation for the ageing of their populations. Now it is America's turn, as George Bush plans to introduce individual accounts into Social Security, the state pension system. However, 60% of old people live in the developing world; by mid-century, 80% will. They, too, will want adequate and affordable incomes in old age. Their governments will also want to consider how, by changing the amounts and the ways people save, pension reform might affect economic development.

In 1994, the World Bank set out its thinking on pensions in developing countries in a landmark report. “Averting the Old Age Crisis” became the reference point for the Bank's approach—one given clout by its lending power. It advocated a move away from pay-as-you-go financing, under which contributions from workers pay for today's pensions. Pay-as-you-go has dominated pension provision in both rich and poor countries. The report backed, where possible, a much bigger role for compulsory funded pensions, paid for by workers saving part of their earnings in retirement accounts.

Since 1994, reforms along these lines have been carried out mainly in Latin America and in the post-Soviet “transition economies”. Chile, in fact, had gone down this route as early as 1981. In all, 12 countries in Latin America have now passed laws introducing mandatory saving; ten have implemented them. In Europe and central Asia, 14 countries have decided to introduce individual accounts; ten have actually made the change.

Eleven years on, the Bank has taken stock, reviewing how reforms have worked and taking account of criticism and new ideas. The result is a new report, to be released on February 21st. “Old-Age Income Support in the 21st Century”, a copy of which *The Economist* has seen, is intended to be the definitive guide to the Bank's current thinking. Although the authors insist that it does not herald a new policy approach, it certainly does alter the Bank's public position.

The new report says that the case for the Bank to support pension reform has grown stronger in the past decade. Existing systems are not good enough. “Most pension systems in the world,” it argues, “do not deliver on their social objectives, they contribute to significant distortions in the operation of market economies, and they are not financially sustainable when faced with an ageing population.”

If experience has reinforced the diagnosis, how has it affected the prescription? In Latin America, for example, reforms to expensive pay-as-you-go schemes have improved governments' long-term fiscal positions. The new funded individual accounts have been costly to run but have generally delivered impressive returns. Nevertheless the number of future pensioners who will benefit looks set to be disappointingly low, because many workers are not covered by the new arrangements.

The Bank has taken this lesson to heart. According to the report, pension reform must take account of workers in the informal economy, who often make up more than half the labour force in developing countries. And it must also cater for people who will be poor throughout their lives.

The Bank now calls for an “enhanced focus on basic income provision for all vulnerable elderly”. Such payments, it says, should be financed by general tax revenues, not workers' contributions. They can take the form of social assistance, means-tested pensions or universal payments from the age of, say, 70. And the Bank now recognises the importance of other resources in old age, such as family help, housing and access to health care.

Pillars of society

As a result, it has extended its “multi-pillar” pension model. In 1994, the Bank described its approach as having three pillars: a public unfunded system; privately managed mandatory saving accounts; and voluntary retirement saving. Now two more pillars have been added: the tax-financed safety-net and the other, mainly non-financial, means of support.

The evidence of the past decade has also led the Bank to temper its enthusiasm for mandatory individual accounts. One of the main hopes of “Averting the Old Age Crisis” was that these accounts would spur economic development. This does appear to have happened in Chile, where reform is estimated to have boosted the rate of economic growth modestly. However, in Argentina, the new accounts have proved vulnerable to political risk. Workers suffered big pension losses when the government defaulted on its debts.

The new report still favours mandatory accounts as a way of raising national saving, improving labour markets and spurring the development of financial systems. But it suggests that they should be considered as a benchmark, not as a blueprint. “Advance funding is still considered useful,” the Bank says, “but the limits of funding in some circumstances are also seen much more sharply.” If funding is to work, a country's macroeconomic and fiscal foundations must be secure. Regulatory and supervisory reforms are also vital.

Since “Averting the Old Age Crisis”, there has been fresh thinking about reforming existing pension systems. Sweden pioneered the idea of “notional accounts”. These maintain pay-as-you-go financing, but treat workers' contributions as if they were paid into individual accounts, which

then form the basis of their pension benefits. Poland and Latvia have also adopted the system. At first, the Bank was sceptical about this idea. However, it has since recognised the potential of notional accounts, which establish a tight link between payroll contributions and eventual pension benefits. They are, says the report, a “promising approach to reform or to implement an unfunded first pillar”.

The new report is overdue. After the 1994 report, the Bank became identified with a narrow focus on the three-pillar concept, and within that on the funded second pillar in particular. In fact, its lending policies have been more flexible: only 30% of its pension-related lending in the past two decades has been for reforms setting up a second pillar. The report therefore aligns the Bank's public position on pension reform with practice.

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Asian equities

Finding something to crow about

Feb 17th 2005 | HONG KONG
From The Economist print edition

Usually, investors look to Asia for growth. Time to think of income

FOR investors in Asian shares, the stars have been aligned auspiciously in the past two years. Traditionally regarded as a play on world economic growth, the region's equities have benefited from strong global expansion, rapid corporate restructuring after the technology bubble and, latterly, recovery from the SARS outbreak. As profits have soared, so have stockmarkets. The MSCI Asia (ex-Japan) index rose by over 40% in 2003 and by 14% last year.

February 11th, however, was the first day of the year of the rooster—a bird that can jump but not fly, as CLSA, a Hong Kong broker, notes. Stockmarket forecasts have lost altitude, not without reason. With global growth softening and interest rates rising, notably in America, investors' appetite for risk may at last be fading. Asian exporters face slower growth abroad, high raw-material prices, growing competition from China and diminishing returns from cost cutting. “Asia is the manufacturing centre of the world and manufacturers enjoy almost no pricing power at all,” says Eddie Wong, chief Asian equity strategist at ABN Amro, a Dutch bank.

According to Markus Rösgen, Citigroup's regional head of strategy research, this means that Asian companies' earnings will grow by less than 3% this year, after 45% in 2004. Expecting weaker profits at technology companies in particular, he would not be surprised if earnings fell by 10-15%. He is not the only pessimist. Institutional funds have already grown warier. A survey by Merrill Lynch of regional money managers, published on February 15th, found that the percentage who think the case for owning Asian equities is strengthening fell from 39% in December to 33% in January and 29% in February.

In such an environment, what might coax investors into parting with their money? Malaysia might: a revaluation of the ringgit, which some think possible, would boost the foreign-currency value of domestic assets. In Indonesia, there are high hopes that the new president, Susilo Bambang Yudhoyono, will crack down on corruption and encourage foreign direct investment. The Thai stockmarket, last year's laggard, should benefit from the overwhelming re-election of free-spending, business-friendly Thaksin Shinawatra. By contrast, China may be best avoided while it struggles to control its runaway growth; Taiwan is too exposed to a faltering technology industry; and South Korea remains mired in credit-card debt.

For industries rather than countries, manufacturers, particularly exporters, are likely to stay squeezed between slowing revenues and rising costs. Energy and mining stocks are exposed to China's appetite for commodities, which may slow as the economy cools. For technology firms, the overproduction of semiconductors, flat screens and computers does not bode well. However, industries focused on domestic consumers, such as banks, utilities, telecoms and retailers should fare better. And Asian shares still look cheap: using prospective 2005 earnings, CSFB's Stewart Paterson puts their price-earnings ratio at 12, against a consensus of 16 for Japan and America and 15 for Europe.

Although Asia may not offer investors supercharged earnings growth, it can certainly provide income. Since the 1997-98 financial crisis, companies have slashed debt and cut reckless overinvestment. Average gearing has fallen sharply, to a 25-year low, notes Mr Rösgen, while the ratio of capital spending to sales has fallen by half, to 8%. Nor are managers blowing the cash on mergers, on which only $10 billion was spent last year. Instead, they are paying it to shareholders. CLSA calculates that dividends grew by 25% a year between 1998 and 2004 (see chart). Indeed, Asian equities now boast a higher yield, 3.3%, than European shares (3.2%) or American ones (2.1%). “This is further proof of the transformation of Asian attitudes to shareholders. Asia is a lot less risky than it used to be,” says Percival Stanion, head of asset allocation at Baring Asset Management in London.

Tighter capital discipline should make Asia a safer, more stable place for investors and, in the short run, a more rewarding one. In the longer run, Asia ought to regain some of its appetite for risk. Its growth prospects, after all, are still remarkable—even if the rooster stays earthbound.

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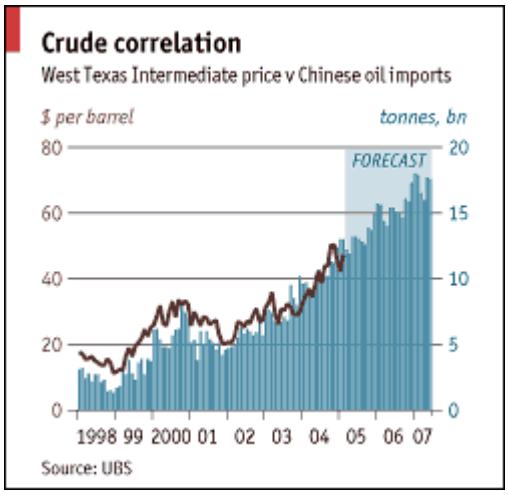
Oil prices and China

Gas-fired dragon

Feb 17th 2005
From The Economist print edition

Chinese demand pushes up prices



A GOOD chart says more than a thousand words. The one below was sent to us by Jonathan Anderson, the chief Asia economist at UBS in Hong Kong. It shows an uncanny relationship between oil prices and China's imports of crude oil. Mr. Anderson admits that the correlation is “almost certainly spurious”: other factors have also been at play. He also admits that contrary to the implications of this chart, UBS expects crude oil prices to decline this year. And yet...

Although China accounts for only 8% of global oil consumption, well below America's 25%, it has accounted for as much as one-third of the increase in global oil demand over the past three years, almost twice as much as America. And China's oil demand will grow as incomes rise and more households can afford cars and energy-consuming household appliances. If UBS's forecasts of China's oil imports are correct, and if (a much bigger if) the relationship in the chart holds, oil prices could hit $70 a barrel within two years. If, on the other hand, China has a hard landing and its oil demand falls, expect prices to plunge.

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Italian banks and the EU

The gatekeeper

Feb 17th 2005 | PARIS
From The Economist print edition

The European Commission tells Italy to open its banking market

EUROPE'S much-promised single market in financial services is taking a long time to create. It might never be finished, indeed, without a fight or two. So it may be a good sign that, after only a couple of months in his job, Charlie McCreevy, the European Union's commissioner for the internal market, is squabbling with Antonio Fazio, governor of the Bank of Italy.

On February 8th Mr McCreevy wrote to Mr Fazio, asking him “to correct the impression” that he is trying to stop foreigners buying their way into Italy's banking market. Several newspapers had reported an unofficial deal between Mr Fazio and the Italian government to block foreign takeovers. Before his official reply was acknowledged on February 17th, the governor had responded indirectly, in a speech last weekend. Foreigners, he said, own on average 17% of the capital of Italy's four largest banks, compared with 7% of Germany's top four and 3% of France's.

That's not the point, says Oliver Drewes, a spokesman for Mr McCreevy: “We are talking about foreigners taking a controlling stake in Italian banks.” According to Italian banking law, the purchase of any more than 5% requires Mr Fazio's nod. On his watch, which began in 1993, no foreign institution has bought a majority stake, although a few have grumbled that they would have but for Mr Fazio's opposition. So far Banco Bilbao Vizcaya Argentaria, Spain's second-biggest bank, has acquired 15% of Banca Nazionale del Lavoro; Santander Central Hispano, Spain's number one, has 8.6% of Sanpaolo IMI. ABN Amro, a big Dutch bank, owns slices of Capitalia and Banca Antonveneta.

Mr Fazio is over-protective because his country's banks are likely to be on several shopping lists should cross-border European bank mergers begin in earnest. Italy's banking market is fragmented and its banks are small. UniCredit, the largest by market capitalisation, ranks only 15th in Europe. It could be bought for a fraction of the price of a top German or French bank.

The governor might be trying to protect the banks' corporate customers too. Loans to large companies such as Parmalat, a dairy group that went spectacularly bust in 2003, and Fiat, a struggling carmaker, are not priced on an economic basis, says Alessandro Roccati, of Fox-Pitt, Kelton, an investment bank; a foreign buyer would surely reprice them, making the companies' restructuring harder than it already is. Small and medium-sized firms might also find credit tighter were their banks bought by unsympathetic foreigners.

As long as Mr Fazio is in charge, Italy's big banks will stay in domestic hands. Parliament is discussing a proposal to limit his term (remarkably, the central-bank governor enjoys life tenure) and to transfer the approval of bank mergers to the antitrust authority, but Italian lawmaking is notoriously slow. The commissioner could take Italy to the European Court of Justice, but Mr McCreevy's people say that is still miles off. The banks' foreign suitors may simply have to wait, and hope that Mr Fazio's successor is more amenable.

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Credit cards

Sub-prime time

Feb 17th 2005
From The Economist print edition

The risky business of lending to people with poor credit records

IN 1880, Sir Joshua Waddilove, a Victorian philanthropist, founded Provident Financial to provide affordable loans to working-class families in and around Bradford, in northern England. This month his company, now one of Britain's leading providers of “home credit”—small, short-term, unsecured loans—began the nationwide rollout of Vanquis, a credit card aimed at people that mainstream lenders shun. The card offers up to £200 ($380) of credit, at a price: for the riskiest customers, the annual interest rate will be 69%.

Provident says that the typical interest rate is closer to 50% and that it charges no fees for late payments or breaching credit limits. Still, that is triple the rate on regular credit cards and far above the 30% charged by store cards. And the Vanquis card is being launched just when Britain's politicians and media are full of worry about soaring consumer debt. Last month, a man took his own life after running up debts of £130,000 on 22 different credit cards.

Credit cards for “sub-prime” borrowers, as the industry delicately calls those with poor credit records, are new in Britain but have been common in America for a while. Lenders began issuing them when the prime market became saturated, prompting them to look for new sources of profit. Even in America, the sub-prime market has plenty of room for growth. David Robertson of the *Nilson Report*, a trade magazine, reckons that outstanding sub-prime credit-card debt accounts for only 3% of the $597 billion that Americans owe on plastic. The sub-prime sector grew by 7.9% last year, compared with only 2.6% for the industry as a whole.

You might wonder, though, how companies can make money from lending to customers they know to be bad risks—or at any rate, how they can do it legitimately. Whereas delinquencies in the credit-card industry as a whole are around 4-5%, those in the sub-prime market are almost twice as high, and can reach 15% in hard times.

Obviously, issuers charge higher interest rates to compensate them for the higher risk of not being repaid. And all across the credit-card industry, the assessment and pricing of risks has been getting more and more refined, thanks largely to advances in technology and data processing. Companies also use sophisticated computer programmes to track slower payment or other signs of increased risk. Sub-prime issuers pay as much attention to collecting debt as to managing risk; they impose extra charges, such as application fees; and they cap their potential losses by lending only small amounts ($500 is a typical credit limit).

All this is easier to describe than to do, especially when the economy slows. After the bursting of the technology bubble in 2000, several sub-prime credit-card providers failed. According to the Federal Deposit Insurance Corporation, an American bank regulator, in December 2000 there were 156 lenders specialising in the sub-prime market (including mortgage lenders and car-loan companies as well as credit-card issuers). Now there are only around 100, of which nine issue

credit cards. Survivors such as Metris and Providian, two of the bigger sub-prime card companies, have become choosier about their customers' credit histories.

As the economy recovered, so did lenders' fortunes. Fitch, a rating agency, says that the proportion of sub-prime credit-card borrowers who are more than 60 days in arrears (a good predictor of eventual default) is the lowest since November 2001. But with American interest rates rising again, some worry about another squeeze. As Fitch's Michael Dean points out, sub-prime borrowers tend to have not just higher-rate credit cards, but dearer auto loans and variable-rate mortgages as well. That makes a risky business even riskier.

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Banking for Native Americans

On the trail

Feb 17th 2005 | COMANCHE COUNTY, OKLAHOMA
From The Economist print edition

The market in financial services for Native Americans is growing, thanks not least to Indian-owned banks

THE heart of the Comanche Indian nation sits on a hilltop next to Interstate 44 in south-central Oklahoma. From here the 12,000-member tribe, self-proclaimed “Lords of the Plains”, oversees businesses that include four casinos, a funeral home, a housing authority, a water park and a museum. The tribal budget has ballooned to $11m this year, thanks largely to money from gambling. Now there are plans for a 5,000-seat convention hall and a hotel. Despite past discrimination from some local bankers, the Comanche leadership—its chairman has a graduate degree from Harvard and the chief financial officer ran a defence-contracting business—is talking with institutions including Merrill Lynch, Lehman Brothers, Bank of America and Bank of Oklahoma about finance for the project.

Changes are afoot in Indian country, and financial institutions are taking notice. Recently Wells Fargo and J.P. Morgan Chase were among the sponsors of “Res 2005” in Las Vegas, an annual trade fair focused on economic development for Native Americans. But despite the efforts of big banks such as Wells Fargo, which has approved commercial loans and credit lines of about $1.5 billion, as well as mortgages, and Washington Mutual, which is in the mortgage business, tribal leaders contend that most of the nation's 2.4m Native Americans remain underserved. Hence the trend toward native-owned banks.

Robert Williams, an expert on tribal law at the University of Arizona, says that Indian country is increasingly divided between the haves (the minority of tribes, like the Comanche, with successful gaming ventures) and have-nots (everyone else). Generally, Native Americans are much poorer and less familiar with banking services than the average American. They are more likely to be denied conventional home-purchase loans. Tribal banks are stepping in to plug the gaps.

The North American Native Bankers Association, a trade body, counts 19 banks nationwide that are owned by tribes or by individual Native Americans. Of these, 11 are in Oklahoma, a state with a rich mix of Indian groups but without huge reservations. Most of the banks are small, with average assets of only $79m, but several are growing fast, and serve not only Indians but other Americans too.

One tribal bank gaining national attention is Bank 2, based in Oklahoma City. Wholly owned by the 40,000-member Chickasaw tribe and with $62m in assets (on September 30th 2004), it is a growing player in the national market for mortgage lending to Indians, thanks in part to effective use of a federal home-loan guarantee programme known as Section 184 and a partnership with Fannie Mae, one of America's giant mortgage companies. About half of Bank 2's customers are Indians, and it does business with more than 80 tribes, including the Comanche. So far it has made no loans tied to casinos. Ross Hill, its president, and J.D. Colbert, who runs its Native American business, both former Federal Reserve officials, often criss-cross the country, speaking

not only to prospective customers but also to other tribes about starting their own banks.

In Denver, a coalition of 18 Indian tribes, two Alaskan native groups and a tribal insurance consortium runs a venture called Native American Bank. The bank, which has assets of $52m, focuses on underserved Indian communities in remote places. Its president, John Beirise, a non-Indian formerly with Continental Bank in Chicago and Mercantile Bank in St Louis, says that one of his unexpected challenges has been “the pervasiveness of politics” in Native American communities and the way it slows change.

Indeed, some say that tribal politics and legal issues hinder Indians' economic advance more than a lack of banks does. “Banks are an effect, not a cause, of economic development,” argues Joe Kalt, co-director of a Harvard programme on Indian economies. Questions of land trust and sovereignty complicate business dealings with tribes, although a growing number of groups are adopting the uniform commercial code and granting waivers that allow banks and other businesses to recoup damages should things go wrong.

Steve Stallings, Wells Fargo's senior executive for native banking, says on the other hand that dealing with tribes is “no different from doing business with certain kinds of regulated industries, doing international business.” Even so, the lending system gets clogged. Mr Stallings estimates he could double his bank's volume of Indian mortgage lending if trust issues were resolved more easily.

Even non-casino tribes are getting more sophisticated about the political and legal reforms needed to get business and finance moving. “They're like little developing countries,” says Mr Kalt. Apparently, some people may even see them as models: he was recently invited to Poland, a country undergoing an economic transition of its own, to lecture on American Indian constitutions.

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Economics focus

The real picture

Feb 17th 2005
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The euro area may have a single currency, but it still has many different real exchange rates

Get article background

HAVE the exchange rates between the 12 members of the euro area been permanently fixed? If you think so, you are wrong. Although their nominal exchange rates have been set in stone, their real exchange rates—ie, adjusted for differences in their rates of inflation—have shifted significantly. Since 1999, when the single currency was launched, Italy's real exchange rate has appreciated by more than 20% relative to Germany's.

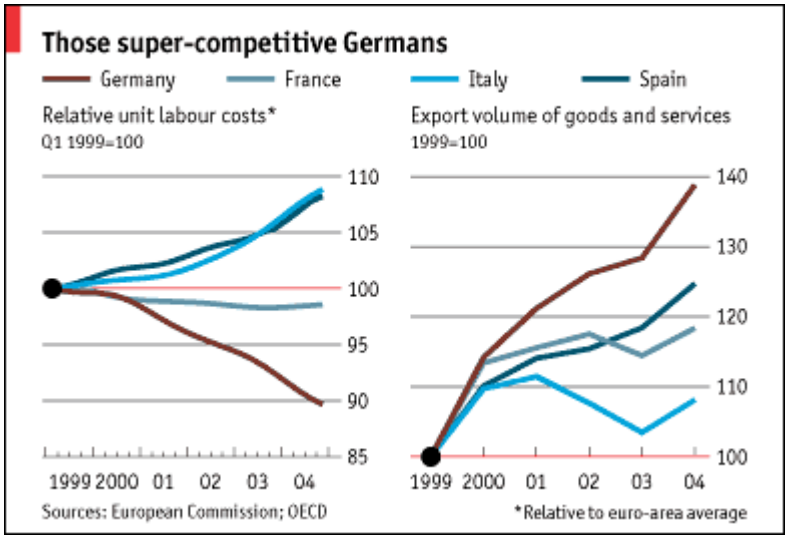
Real exchange rates measure international competitiveness, and are therefore more important than nominal rates in terms of their economic impact. For example, if the dollar fell by 10% against the euro, but at the same time prices in America rose by 5% more than those in Europe, the price of American goods relative to European ones measured in a common currency—the dollar's real exchange rate—would fall by only 5%. Likewise, within the euro zone, if prices in Italy, say, rise more rapidly than those in other member countries, then Italy's real exchange rate against its neighbours will rise even though the nominal rate is fixed.

The European Commission calculates on a quarterly basis real effective (ie, trade-weighted) exchange rates for euro-area economies against other member countries as well as against a basket of external currencies such as the dollar, the yen and the pound. This requires for each country an index of inflation relative to that abroad. The tricky part is deciding exactly which price or cost deflator to use. The commission publishes no fewer than five different indices, based on consumer prices, the GDP deflator, export prices, unit wage costs in manufacturing, and unit labour costs across the whole economy. Each measure has its advantages and disadvantages. For instance, a real exchange rate based on relative export prices might seem to be the most direct way to capture international competitiveness. But it might tell only half the story, if firms initially absorb an increase in costs by trimming profit margins; eventually, export prices will rise. A real exchange rate based on consumer prices offers the most timely figures, because prices are available monthly, but it may be distorted by the inclusion of indirect taxes and non-traded goods and services. Most economists reckon that the best measure of underlying international competitiveness is relative unit labour costs.

When the single currency was born, Germany's unit labour costs were the highest in the euro area; but since 1999 they have fallen by 10% relative to the average. Put another way, Germany's real exchange rate within the zone has depreciated by 10%. In contrast, relative unit labour costs have risen by 9% in Italy, Spain and the Netherlands, implying a huge loss of competitiveness relative to Germany (see left-hand chart). Economists at ABN Amro estimate that Germany's labour costs are now lower than Italy's. Ireland and Portugal have also lost competitiveness.

German labour costs surged in the early 1990s when the reunification boom boosted wages, labour taxes were increased and the D-mark rose against other European currencies. But more recently, German firms have struggled to regain their competitiveness by clamping down on wages and boosting productivity. In the past five years Germany has boasted faster growth in labour productivity than the euro-area average, combined with the zone's slowest growth in wages. The threat that firms will move factories to central and eastern Europe has forced workers at several large companies either to work longer hours without extra pay or to take a pay cut. The government's reforms will also help to reduce labour-market rigidities, making it easier for firms to dismiss workers and forcing unemployed workers to seek jobs.

In the long run this will help firms to become more competitive and profitable, and so create more jobs. However, in the short run unemployment has risen, and incomes and consumer spending have been squeezed. Germany's GDP fell by 0.2% in the fourth quarter as export growth was more than offset by a fall in domestic demand.



The divergent dozen

There has also been a lot of variation in the effective exchange rates of individual euro-zone economies against the rest of the world. This reflects differences not only in cost inflation, but also in the geographic patterns of trade. If, for example, a bigger share of a country's exports go to America, then the dollar will have a bigger weight in that country's currency basket.

Since early 2002, when the dollar started its decline, the euro's real trade-weighted exchange rate has risen by 18% (based on relative unit labour costs), slightly less than the 21% rise in its nominal trade-weighted value and considerably less than its 50% leap against the dollar. Yet Germany's real effective exchange rate has risen by only 4% since early 2002, the smallest increase of any euro-zone country. France's real exchange rate has gone up by 9%, and those of Italy and Ireland by 17%.

It turns out that the real exchange rates of the individual members of the euro area have all gone up by less than the 18% rise of the euro itself. This might strike you as odd. The explanation is that the trade weights used to calculate the euro's overall index against other currencies exclude trade within the euro area, which accounts for around half of most members' total trade. When calculating national effective exchange rates this trade should rightly be included, giving a much smaller weight to the declining dollar.

Many economists worry that the cheap dollar will crush European business. But the modest rise in Germany's real trade-weighted exchange rate explains why, despite the euro's surge against the dollar, German exports have held up so strongly (see right-hand chart). Indeed, Germany is the only G7 economy to have increased its share of world exports in the past five years. The popular notion that high wage costs have left Germany uncompetitive no longer seems to be true. Alas, it could take some time before the gains feed through to household incomes and spending, and spur the German economy to grow again.

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Border controls

New-look passports

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From The Economist print edition

KOBAL COLLECTION

High-tech passports are not working

IN OLDEN days (before the first world war, that is) the traveller simply pulled his boots on and went. The idea that he might need a piece of paper to prove to foreigners who he was would not have crossed his mind. Alas, things have changed. In the name of security (spies then, terrorists now), travellers have to put up with all sorts of inconvenience when they cross borders. The purpose of that inconvenience is to prove that the passport's bearer is who he says he is.

The original technology for doing this was photography. It proved adequate for many years. But apparently it is no longer enough. At America's insistence, passports are about to get their biggest overhaul since they were introduced. They are to be fitted with computer chips that have been loaded with digital photographs of the bearer (so that the process of comparing the face on the passport with the face on the person can be automated), digitised fingerprints and even scans of the bearer's irises, which are as unique to people as their fingerprints.

A sensible precaution in a dangerous world, perhaps. But there is cause for concern. For one thing, the data on these chips will be readable remotely, without the bearer knowing. And—again at America's insistence—those data will not be encrypted, so anybody with a suitable reader, be they official, commercial, criminal or terrorist, will be able to check a passport holder's details. To make matters worse, biometric technology—as systems capable of recognising fingerprints, irises and faces are known—is still less than reliable, and so when it is supposed to work, at airports for example, it may not. Finally, its introduction has been terribly rushed, risking further mishaps. The United States want the thing to start running by October, at least in those countries for whose nationals it does not demand visas.

Your non-papers, please

In theory, the technology is straightforward. In 2003, the International Civil Aviation Organisation (ICAO), a UN agency, issued technical specifications for passports to contain a paper-thin integrated circuit—basically, a tiny computer. This computer has no internal power supply, but when a specially designed reader sends out a radio signal, a tiny antenna draws power from the wave and uses it to wake the computer up. The computer then broadcasts back the data that are stored in it.

The idea, therefore, is similar to that of the radio-frequency identification (RFID) tags that are coming into use by retailers, to identify their stock, and mass-transit systems, to charge their passengers. Dig deeper, though, and problems start to surface. One is interoperability. In mass-transit RFID cards, the chips and readers are designed and sold as a package, and even in the case of retailing they are carefully designed to be interoperable. In the case of passports, they will merely be designed to a vague common standard. Each country will pick its own manufacturers, in the hope that its chips will be readable by other people's machines, and vice versa.

That may not happen in practice. In a trial conducted in December at Baltimore International Airport, three of the passport readers could manage to read the chips accurately only 58%, 43% and 31% of the time, according to confidential figures reported in *Card Technology* magazine, which covers the chip-embedded card industry. (An official at America's Department of Homeland Security confirmed that “there were problems”.)

A second difficulty is the reliability of biometric technology. Facial-recognition systems work only if the photograph is taken with proper lighting and an especially bland expression on the face. Even then, the error rate for facial-recognition software has proved to be as high as 10% in tests. If that were translated into reality, one person in ten would need to be pulled aside for extra screening. Fingerprint and iris-recognition technology have significant error rates, too. So, despite the belief that biometrics will make crossing a border more efficient and secure, it could well have the opposite effect, as false alarms become the norm.

The third, and scariest problem, however, is one that is deliberately built into the technology, rather than being an accident of its present inefficiency. This is the remote-readability of the chip, combined with the lack of encryption of the data held on it. Passport chips are deliberately designed for clandestine remote reading. The ICAO specification refers quite openly to the idea of a “walk-through” inspection with the person concerned “possibly being unaware of the operation”. The lack of encryption is also deliberate—both to promote international interoperability and to encourage airlines, hotels and banks to join in. Big Brother, then, really will be watching you. And others, too, may be tempted to set up clandestine “walk-through inspections where the person is possibly unaware of the operation”. Criminals will have a useful tool for identity theft. Terrorists will be able to know the nationality of those they attack.

Belatedly, the authorities have recognised this problem, and are trying to do something about it. The irony is that this involves eliminating the remote readability that was envisaged to be such a crucial feature of the system in the first place.

One approach is to imprison the chip in a Faraday cage. This is a contraption for blocking radio waves which is named after one of the 19th-century pioneers of electrical technology. It consists of a box made of closely spaced metal bars. In practice, an aluminium sheath would be woven into the cover of the passport. This would stop energy from the reader reaching the chip while the passport is closed.

Another approach, which has just been endorsed by the European Union, is an electronic lock on

the chip. The passport would then have to be swiped through a special reader in order to unlock the chip so that it could be read. How the European approach will interoperate with other countries' passport controls still needs to be worked out. Those countries may need special equipment or software to read an EU passport, which undermines the ideal of a global, interoperable standard.

Sceptics might suggest that these last-minute countermeasures call into doubt the reason for a radio-chip device in the first place. Frank Moss, of America's State Department, disagrees. As he puts it, “I don't think it questions the standard. I think what it does is it requires us to come up with measures that mitigate the risks.” However, a number of executives at the firms who are trying to build the devices appear to disagree. They acknowledge the difficulties caused by choosing radio-frequency chips instead of a system where direct contact must be made with the reader. But as one of them, who preferred not to be named, put it: “We simply supply all the technology—the choice is not up to us. If it's good enough for the US, it's good enough for us.”

Whether it actually is good enough for the United States, or for any other country, remains to be seen. So far, only Belgium has met America's deadline. It introduced passports based on the new technology in November. However, hints from the American government suggest that the October deadline may be allowed to slip again (it has already been put back once) since the Americans themselves will not be ready by then. It is awkward to hold foreigners to higher standards than you impose on yourself. Perhaps it is time to go back to the drawing board.

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Restoring hearing

Hair tonic

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Gene therapy may restore lost hearing and balance

EVOLUTION has provided people with an exquisitely sensitive system of hearing and balance—the inner ear. But that sensitivity comes at a price, for the inner ear is also the sensory system most susceptible to damage. Nearly one child in 1,000 is born profoundly deaf, and if you are lucky enough to live to be 80, you have a 50% chance of losing enough of your hearing on the way for normal conversation to be troublesome without a hearing aid.

Often, the reason is damage to specialised sensory cells known as hair cells. The hair-like cilia that give these cells their name act as transducers. They convert the vibrations of sound into electrical impulses that the nervous system can handle. But cilia are fragile. Loud noises, such as those produced by machinery and booming stereos, can knock them away. So can some infections, such as meningitis. And so can some antibiotics. This damage is, at the moment, irreversible. But if Yehoash Raphael of the University of Michigan and his colleagues have their way, that will not be true for much longer.

Over the past two decades, many of the genes required for ear development have been identified. One of the most important is called *Math1*. But it is active only in embryos. Dr Raphael wondered, therefore, whether it would be possible to turn it on in adults, and thus generate new cilia.

The adults in question were guinea pigs—both literally and metaphorically. (Despite the colloquial use of the name, experiments involving rodents more often use mice or rats.) They were treated with antibiotics, to kill their hair cells. This made them completely deaf. Then, after four days, their left ears were infected with an adenovirus (one of the sorts of virus that cause colds). Half the infections were with viruses that had had a *Math1* gene engineered into them. Half used viruses that had had a dummy DNA sequence engineered in instead. The hope was that the *Math1* gene would be activated in the infected cells, which would then grow cilia, thus becoming hair cells. And it worked. As Dr Raphael reports in *Nature Medicine*, eight weeks later the animals treated with *Math1*-carrying adenovirus had regenerated their hair cells and were able to hear.

Their hearing was not restored completely. Although they were able to perceive sounds in the range of 40-50 decibels—similar to the volume of a typical conversation—Dr Raphael suspects that what they heard was rather fuzzy. That is because the treatment only caused the regrowth of a group of cells called the inner hair cells. These determine the threshold of hearing. A second group, the outer hair cells, did not reappear. The outer cells are responsible for amplifying sound, and for modulating its quality. Dr Raphael suspects that a second gene will need to be added to the viral package to stimulate the outer cells' regrowth.

Meanwhile, at the University of Maryland, Hinrich Staecker has been doing similar experiments designed to restore balance in mice. In these experiments, which have yet to be published, he uses an antibiotic injection to knock out the hair cells devoted to balance. (These cells work by

detecting movements in the fluid that fills the canals of the inner ear.) Forty-eight hours later, he injects the animals with adenoviruses containing *Math1* genes. A month after the injection, the animals have regained their sense of balance.

Both groups of researchers think this is the beginning of a new approach to treating inner-ear problems. Dr Staecker predicts that the first *Math1* gene-therapy trials will happen in people who have lost their sense of balance. If those work, hair cell-regeneration treatments for deafness may follow. There is still a long way to go. Trials of any kind are probably five years away. But it looks as if science is having more luck restoring the hairs of the ears to youthful vigour than it is with the hairs of the head.

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Visas and science

American express?

Feb 17th 2005
From The Economist print edition

Improvements in the visa-issuing process for foreign scientists

Get article background

IN THE days since September 11th 2001, the news for foreign scientists and students who wished to work in—or even visit—America has been grim. Delays in issuing visas soared, and applications to American graduate schools by foreign science students sank by 30%. This has been bad not only for the individuals concerned, but for science as a whole.

In the past few days, though, some good news has emerged. On February 14th, America's State Department announced that “Visa Mantis” clearances—required for scientists working in sensitive areas—would be given for four years to students and two to working scientists, up from the previous limit of a year. Visa Mantis is a system for doing background checks on a visa applicant. Data on an applicant are sent from the American consulate in the applicant's country to the Federal Bureau of Investigation and “other agencies”—a bureaucratic euphemism for the intelligence agencies. These search their databases and reply to the State Department with any objections. The department, in turn, replies to the consulate.

Part of the problem with the Visa Mantis system was that it entailed lengthy delays. A report issued in February 2004 by the Government Accountability Office (GAO), a congressional watchdog, found that the average wait for clearance during spring 2003 had been 67 days. According to the State Department, those delays are now down to an average of two weeks—a claim that the GAO is expected to confirm in an updated report that was being prepared for release as *The Economist* went to press.

A Mantis clearance is necessary but not sufficient for a visa. But processing times for visas themselves seem to be improving as well. America's National Academies of Science, Engineering and Medicine, the chief professional bodies of those disciplines, collect informal data on those cases of long delays that are reported to them (approximately 800 a year). These show that delays decreased from an average of 145 days in 2003 to 65 days in 2004.

Much remains to be done—two months is still quite a while to wait. And as Maura Harty, the State Department official in charge of consular affairs, puts it, “the loss of even one qualified student to another nation is one too many.”

Quite so. But while America now seems to grasp the cost of treating foreign brains badly, Britain does not. New figures show the number of foreign students admitted to British universities in 2004 fell by 5.3%. That may reflect the stonking fees charged for visas since 2003—which, to universities' dismay, the government has just decided to double.

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Amateur astronomy

Running rings around a distant planet

Feb 17th 2005
From The Economist print edition

Astronomers may have found their first Saturn lookalike

LAST summer, millions of people around the world watched the silhouette of Venus slide across the face of the sun—the first such “transit” for 122 years. At about the same time, a team of professional astronomers was pulling off a similar trick for a planet the size of Jupiter in orbit around a star 32m times farther from Earth than the sun. It was the first triumph for the Trans-Atlantic Exoplanet Survey (TrES), a set of three tiny telescopes, one on Tenerife and the other two in Arizona and California. Each telescope has a mirror just 10cm across, yet working together they detected the microscopic dimming caused by a planet getting in the way of the distant star.

Having announced the existence of TrES-1b, as the planet is now known, the TrES team stopped watching and moved on to search for others. In so doing, it may have missed the greatest surprise of all. For TrES-1b appears to be surrounded by a massive ring system, like Saturn's but bigger. And this discovery was made not by professionals, but by a network of amateur astronomers spread throughout the world, using back-garden telescopes and swapping their data via the internet.

Transitsearch.org, as the amateur network is known, was actually dreamed up by a professional. It is the brainchild of Greg Laughlin of the University of California, Santa Cruz. He realised that some of the off-the-shelf equipment used by serious amateurs is sensitive enough to measure the light drop caused by distant transits. His irregulars soon went to work on the newly discovered TrES-1b, and when they pooled their results they found that there was a peculiar rippling pattern of brightening and dimming lasting about 40 minutes at the beginning and the end of each transit. This rippling suggested a series of rings crossing in front of the star in advance of, and then behind, the profile of the transiting planet.

Not everyone is convinced—if only because the rings would have to be much denser than those of Saturn in order to explain the observation. But it is enough for Timothy Brown, the leader of the TrES team, to have booked time on the *Hubble* space telescope to have a better look. And if he sees rings too, then it will be a feather in the cap of amateur science.

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West End theatre

King of the stage

Feb 17th 2005
From The Economist print edition

London's biggest theatrical surprise is a provincial production of a three-hour German epic. Whatever you do, don't miss "Don Carlos"

FRIEDRICH SCHILLER, romantic poet and playwright, is an immortal in Germany, but he has never made much of a splash in the London theatre. Discerning critics have, for a generation now, used the National Theatre's failure to perform Schiller's work as a stick with which to beat successive directors, who, in turn, have shrugged off these attacks with the retort that there is no audience for wordy, Germanic pieces. Verdi's treatment of Don Carlos is infinitely more familiar to Londoners than Schiller's original play.

But something strange and unpredictable has happened this winter. Schiller is playing in Shaftesbury Avenue, the heart of the commercial theatre in the West End. The reviews have been raves: "a masterpiece in a masterly production," wrote John Gross in the *Sunday Telegraph*. Theatre-goers are queuing round the block at the Gielgud theatre; "Don Carlos" is the hottest ticket in town. Michael Billington, theatre critic of the *Guardian*, who has been a persistent advocate for the work,rejoices: "The idea that Schiller is now big box office marks an historical watershed."

It has already been a memorable winter for drama in London. There have been three intriguing productions of "Macbeth", one as part of the Royal Shakespeare Company's season of Shakespeare's tragedies. The RSC has also brought in from Stratford-upon-Avon a season of plays from Spain's Golden Age, and there are some excellent revivals of work by Noel Coward, Terence Rattigan and David Mamet. "For a serious, committed theatre-goer, the West End is heaven at the moment," says Michael Grandage. His own contribution has been to direct the compelling "Don Carlos".

Yet, Mr Grandage says, it was only a few months ago that he was being asked to contribute to symposiums about the death of the London theatre. Reports of its demise have been exaggerated, but that is not surprising. The West End theatre feeds on elation or despair. Until recently, the critics had been disappointed by a meagre diet of good drama, though this did not affect revenues. The Society of London Theatre reports takings of £341m ($644m), which make 2004 its most prosperous year ever.

Long-running musicals put no less than 61% of the 11,938,999 bums on seats, but drama provided a solid 25% of the audience. The rest attend opera and dance. What is so gratifying, and different, about this winter is the extraordinary blend of box-office returns and dramatic quality.

Mr Grandage is the most talented of a new generation of director-managers in Britain. He is 43, bearded and spirited, approachable and earnest. Until this year, he had been running the prestigious Donmar Warehouse in London, and the subsidised theatre complex in Sheffield, where “Don Carlos” opened last October. Schiller's play was the farewell production in his uncompromising regime: “I wanted to go out with ‘Don Carlos' because my object for a five-year term was to build an audience for the classical repertoire beyond Shakespeare,” Mr Grandage says. Full houses for the run in Sheffield suggest that he may have succeeded.

“Don Carlos” is a forbidding project. Written in blank verse, the full text runs for seven hours. Heavy editing was required, which Mr Grandage saw as a challenge: “It gives you quite a lot of leeway,” he says. Mike Poulton, the adapter, dropped the blank verse, and updated the idiom. (Schiller might have resisted such lines as: “She's spent too long on her back.”). The script has been cut to less than three hours, and it plays like an historical thriller.

At the start of this production, a thurible breathing incense swings across the stage, which is lit by shafts of light from high windows. (The lighting, which is by Paule Constable, is striking.) This is a drama about church and state, freedom and authority. It is set in the late 16th century when the Netherlands are in revolt against the reign of terror imposed by the Spanish king, Phillip II—acted with impeccable clarity by Sir Derek Jacobi, who in an evening's work restores a reputation that many West End managers believed was past its best.

“Don Carlos” was written two years before the French revolution, and the good men belong to that time. Carlos, the king's son, and his friend the Marquis of Posa favour humanity, liberty and freedom of speech. Posa almost persuades Phillip of the case for freedom. But, true to history, when the curtain falls, the good men have lost. The dramatic climax is the entrance of the real villain—the imposing, sinister figure of the Inquisitor, clothed in a cardinal's scarlet. When he instructs the king in his duty to God and the Roman Catholic church, Phillip does his bidding—but Schiller has made the case against tyranny. Mr Grandage declares that the message rings no less true, and is no less relevant, on Shaftesbury Avenue in 2005.

The good news from the West End, according to the director, is that high-quality productions of classics and new plays at the National Theatre and by companies such as his own in London and Sheffield have raised standards and expectations in London. “I hope what we've done is to redefine what the West End can do when it takes risks,” he says.

Can this golden period last? Mr Grandage hopes so, but his experience tells him that West End theatre, like the trade cycle, is a creature of peaks and troughs. Enjoy the view while it lasts.

“Don Carlos” is at the Gielgud theatre, London, until April 30th

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Nepal

Mountain madness

Feb 17th 2005
From The Economist print edition

Books

Forget Kathmandu: An Elegy for Democracy
by Manjushree Thapa

Penguin Viking; 260 pages; Rs 350

WHEN Nepal, as it occasionally does, recently made international headlines, it was for a piece of news that sounded as if it came from a different epoch: a king abolishing democracy and restoring absolute monarchy. Among the country's many curses is its exotic image as a place rich in high mountains, cheap dope and colourful tradition, including a king revered as a reincarnated deity. This makes it especially prey to orientalist condescension, in particular the argument that it is “not ready” for democracy, and may be better off with a royal dictator.

A healthy corrective is Manjushree Thapa's new book, “Forget Kathmandu”. In 2001, Ms Thapa, a Nepali who writes in English, published “The Tutor of History”, a novel set during the democratic interlude that began in 1990. After a popular protest campaign multiparty politics was introduced under a constitutionally constrained monarchy.

“Forget Kathmandu” is a work of non-fiction: part memoir drawn from living through the recent turmoil, part history of the royal family, part reportage on a trip Ms Thapa made to areas controlled by Maoist rebels, and partly also a reflection on what has gone so desperately wrong with her country. It is probably the best, and certainly the most readable, single-volume attempt to address that last question.

Ms Thapa's starting-point is the episode that inspired Nepal's last round of headlines: the massacre of the royal family in 2001 by the crown prince, high on drink, ganja and an unidentified “black substance”, who rounded off his killing spree by shooting himself. This was more than spectacular melodrama. It was a pivotal event. It brought to power the present king, Gyanendra, who is less popular than his predecessor and tainted by wild suspicions that he was somehow responsible for the massacre even though he was out of town on the night it happened.

In 2002 King Gyanendra dismissed the elected government and started ruling through appointees. At the beginning of this month, he sacked his appointees and locked them up, along with hundreds of others, while imposing a blanket censorship and suspending civil liberties. “Forget Kathmandu” was written before the recent events. The book is an elegy for democracy, even if in Nepal democracy was represented between 1990 and 2002 by a series of short-lived governments that “continued to botch and bungle”, Ms Thapa says. A Maoist rebellion has been spreading across the whole country since 1996, taking 11,000 lives in the process.

The army, which has remained under the king's command, has been inept—and brutal—as a counter-insurgency force. Political parties can certainly be blamed for some of Nepal's agony. The chief culprit, however, is the monarchy, for which the 2001 massacre was just the latest episode in generations of vicious infighting between crackpot kings, bloodthirsty regents, scheming queens and hereditary prime ministers.

As for the Maoists, the only people to speak well of them and their reign of terror, Ms Thapa discovers, are Maoists themselves. The justification given for the recent royal coup was the need for the king and the army to deal with the insurgency without the time-consuming distractions of politics and freedom. Some Nepalis have yielded to what Ms Thapa calls “a retreat from idealism into a knowing irony and its source, despair”. They are ready to give the king the benefit of the doubt. But there is little sign that he deserves it.

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About sponsorship

Migration and illegal immigrants

Accidents of birth

Feb 17th 2005
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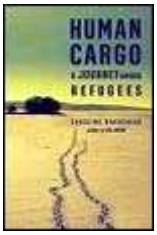
IT IS her ability to tell stories that gives Caroline Moorehead's book its power. She has written some splendid biographies and set up services for refugees in Cairo, but she is a journalist first and foremost. In writing this memorable book, she has talked to the Sicilians who fish drowning Africans from shipwreck, and to the priests who care for Mexicans trying to cross America's high-fenced southern borders. Above all, she has talked to the refugees themselves: to Liberians sleeping rough in Cairo, to Iranians incarcerated in Australian detention centres, to Congolese waiting in north-of-England towns to know whether their asylum claims have been accepted.

The refugees' stories can be heart-rending. The parents and siblings of Musa Sherif, one of a group of young Liberians she works with in Cairo, were all murdered by Charles Taylor's soldiers. He lost track of his wife and children, and then slowly lost hope as his claim to resettlement lay in limbo. A few tales end in a new life: a young Liberian who had seen his father roasted over an open fire goes to live with cousins in New York and saves up to buy a taxi. “We all live in the Bronx and we are happy together,” he tells her.

Human Cargo: A Journey among Refugees
By Caroline Moorehead



Henry Holt; 316 pages; $26.
Chatto and Windus; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Some of the stories told by those who try to help are more ambiguous. Italian villagers shelter a group of Africans rescued from a Mediterranean storm; as time passes, the refugees grow more reticent, and their accounts change in ways that unsettle their hosts. After a few months, they vanish. “We didn't help them for gratitude,” says one of the Italians. “But to leave saying nothing? It made us feel foolish, used.” Deception, which can be common among asylum-seekers, inevitably breeds cynicism and resentment.

As the flow of refugees grew in the mid-1990s—when 19m people, half of them under 18, were believed to be in flight—so rich countries have behaved in ways that are hard to defend. A young man tries to commit suicide in the streets of Newcastle, protesting: “You have to kill yourself in this country to prove that you would be killed in your own country.” The giant fence sealing Mexico from America stands in contrast to the Statue of Liberty. In the 43 years that the Berlin Wall shut Communism's refugees in, it accounted for 239 deaths. America does not shoot migrants, yet in 1991-2001, at least 1,700 people died crossing its border deserts.

Having seen so much misery among the displaced, she wonders understandably why the accident of birth should determine where one is allowed to live. But migration is not a simple issue. The voices largely missing from this book are of those who want to keep the refugees at bay. The uncertainties of migration in rich countries result, she notes, from a clash between the democratic will of voters, often hostile, with the rule of law, “which makes excessive exclusion impossible”.

Missing, too, is some sense of what a solution to this clash might be. She talks hopefully of “managed migration”. But this phrase is used both by liberals and by excluders to mean entirely different things. If a country manages migration for the economic benefit of its own citizens, it may hesitate to accept newcomers who speak only their own language, have little education, and whose years have been so disrupted by war and brutality that they may find it hard to live normal and productive lives.

And yet, that too may be the wrong answer, as is clear from the stories of Ms Moorehead's Liberians. Selecting refugees who might flourish is a lottery. Mohammed, who saw his godmother kicked to death, is now a mechanic in Austin, Texas. Give people security, education and a chance, and they may move from horror to happiness with surprising speed.

Human Cargo: A Journey among Refugees.
By Caroline Moorehead.
Henry Holt; 316 pages; $26.
Chatto and Windus; £12.99

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The Oscars

Winged victors

Feb 17th 2005
From The Economist print edition

This year's Academy awards are really anyone's guess

WHILE analysts of the Roman Catholic church have been parsing Vatican statements this month about the real state of the pope's health, halfway around the world a similar sort of sifting of the tea leaves has been under way in Hollywood. In sharp contrast to 2004, when "Lord of the Rings" won all 11 Oscars for which it was nominated, there are no obvious winners among this year's celluloid *papabili*.

Cate as Kate

The Oscars, of which this year's round is due to be announced on February 27th, were never an independent measure of excellence. The members of the Academy of Motion Picture Arts and Sciences, who confer them, work in the industry, and their tastes favour those who make them feel good about themselves.

As always in Hollywood, the money comes first. A "best film" has to be one that the public endorses, confirming the judgment of those who made it. In recent years, that has meant a movie that grosses $100m in North America alone. None of this year's best-picture nominees has grossed that much so far. That said, though, winning an Oscar can do wonders for a straggler. "Chicago", which took best-picture in 2002, picked up 41% of its eventual box-office takings after winning the trophy. Academy members will be looking to this year's victor to do something similar.

But making big money is not the whole story. "Star Wars" and "Jaws" both did that, but were largely ignored by the Academy. To win, a film must also reflect credit on the industry. Films like "A Beautiful Mind" win precisely because they appeal to Hollywood's intelligentsia.

So what is in the running this year? Among the specialist categories, there is no real competition as best animated film for "The Incredibles", while best documentary will most probably go to "Super Size Me", as Michael Moore's "Fahrenheit 9/11" (whose style it so obviously apes) was disqualified for having been shown first on television.

As best film, the front-runner with 11 nominations is "The Aviator", Martin Scorsese's biopic of the film-and-aviation tycoon, Howard Hughes. Rarely has the most nominated film failed to clinch best picture. In a way, that is understandable. All-round excellence surely betokens quality, even if other films may be judged to be superior in the individual categories.

“The Aviator” certainly has the right subject—the father of modern aviation and the father, with his 1930 film “Hell's Angels”, of course, of modern action movies. Who, from Tinseltown's perspective, could be more relevant to the 21st century?

What is it up against? “Sideways” (see article) is the kind of semi-independent film that Hollywood likes to acknowledge with a nomination—and then pass up for a best-film award. “Finding Neverland”, about how J.M. Barrie came to write “Peter Pan”, wins brownie points for integrity, while “Ray”, about Ray Charles, may have to settle for the best-actor prize only.

That leaves, as fifth contender for best picture, “Million Dollar Baby”, Clint Eastwood's boxing flick. It is a fine film, but would Hollywood be happy saluting a picture that is also a vote for euthanasia? On the other hand, Mr Eastwood has been named best director before, in 1992 for “Unforgiven”, and could well win that award again. He is popular in Hollywood, and the way he has evolved from starring in spaghetti westerns to a director of substance commands respect. One pointer is that he won the Directors' Guild of America award for “Million Dollar Baby” and only six times in the past 56 years has this award failed to be matched by an Oscar. An Eastwood victory would, however, be a bitter blow to Mr Scorsese, who has long been recognised as a force to be reckoned with and has never won an Oscar.

Best actor is easier to predict. Notwithstanding Leonardo DiCaprio's spirited rendering of Howard Hughes, Jamie Foxx seems certain to snap up the award for his performance as Ray Charles. It is a tour de force, whereas the others, Mr DiCaprio excepted, seem also-rans. They include Mr Eastwood in his acting capacity, the ever-youthful Johnny Depp as J.M. Barrie and Don Cheadle in “Hotel Rwanda”.

Picking best actress will not be so easy. Of this year's five nominees, Catalina Sandino Moreno in “Maria Full of Grace” stands only the slightest chance of winning. By contrast, Imelda Staunton in “Vera Drake” rends the heart as no other actress has managed this year. Hers is undeniably a great performance, though it may well be overlooked by voters who have not seen the film. Annette Bening in “Being Julia” or Hilary Swank in “Million Dollar Baby” look better bets.

Despite competition from Cate Blanchett, playing Katharine Hepburn in “The Aviator”, and Clive Owen in “Closer”, the supporting Oscars are likely to go to two of the actors in “Sideways”. Thomas Haden Church, as an about-to-be-wed Romeo, and Virginia Madsen, the waitress who is keen to prove that she knows about the finer things in life—like classic wine vintages. Ms Madsen has too long been typecast as a glamour girl; now it is becoming apparent that there is more to her than previously imagined.

Two trophies to “Sideways”, two to “Million Dollar Baby” and a best film to “The Aviator” would be a fair division in a lacklustre year. But the Oscars would not be the Oscars without a surprise or two.

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African cinema

Spit roasts and first ladies

Feb 17th 2005 | OUAGADOUGOU, BURKINA FASO
From The Economist print edition

A report from the centre of Africa's film industry

IT IS unusual for a cinema to erupt into spontaneous applause at the murder of a first lady. Especially when a first lady—in this case Chantal Compaoré, wife of Burkina Faso's long-standing president—is in attendance.

This was the unexpected climax of “La Nuit de la Verité”, a new African film in which the president's wife kills a rebel leader by basting and barbecuing him on a spit—a fate that befell an uncle of the director, Fanta Régina Nacro. The film, which premiered in Burkina Faso last month, is now a front-runner for the grand prize at this year's Fespaco, the biennial pan-African festival of cinema and television, which opens in Ouagadougou on February 26th.

The festival loves a shindig. Last time round, organisers chartered a plane from Paris to fly in visiting celebrities and dignitaries. This year, officials from the European Union, which helps fund the festival, have been scratching their heads at the long list of freeloaders demanding a plane ride and hotel room for the trip.

Danny Glover, an American actor, is jetting in to judge the films competing for the coveted Etalon de Yennenga prize—Fespaco's equivalent of the Palme d'Or at Cannes. The opening and closing ceremonies will take place in the national stadium in front of 50,000 people.

Since the first Fespaco in 1969, little-known landlocked Burkina Faso has become the capital of African cinema. But times are hard. Ticket prices have risen, piracy is spreading and cinema attendance has dropped by half in recent years. Of 55 cinemas nationwide, only 34 actually work.

Audiences survive on a treacly diet of Hollywood and Hong Kong action movies, with African films making up less than 1% of the market. State funding is infrequent, and purists complain that local film-makers, who rely on Europe for production grants, draw too heavily on western ideas of what African films should be. Many of the films up for the big gong this year are co-produced in Europe, including “La Nuit de la Verité”.

Yet there is hope. Last year, the state privatised all film distribution. Directors and producers are optimistic that this will inject some of the rigour and enthusiasm that is necessary for Africans to hit the big screen once again. As Oscar fever mounts nearly 7,000 miles away, African cinema will be making its mark in Los Angeles. An isiZulu film, “Yesterday”, has been nominated for an Academy award for the first time, for best “foreign” picture. And “Hotel Rwanda”, which was also filmed largely in South Africa, has received three nominations. Fespaco's hot local talents could be the Oscar winners of tomorrow.

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American comedy films

Life as a laugh

Feb 17th 2005 | LOS ANGELES
From The Economist print edition

A spoonful of sugar makes the medicine go down

IN ALEXANDER PAYNE'S “Sideways”, Miles, the main character, played by Paul Giamatti, downs his daily Xanax with a glass of wine.

Miles's problems are also America's, which may be one reason why this sly comedy has struck such a chord. Some of the other topics that flit subliminally by in this film are divorce, infidelity, binge drinking, abandoned parents, outsourced children, underpaid schoolteachers, downward mobility, multiculturalism and the ugliest commercial architecture ever filmed, which blocks the view of California's wine country. This is the last frontier left to which Miles and his buddy Jack (Thomas Haden Church) can run before Jack marries the daughter of a wealthy Armenian to escape his career as the warning voice at the end of television commercials for loans and pharmaceuticals.

Mr Payne smuggles in his observations about modern American life in the same way that Dino Risi commented in passing on post-war Italy's economic miracle in his 1963 tragicomic road trip, “The Easy Life”, starring Vittorio Gassman and Jean-Louis Trintignant, whose memory-images smile down on Mr Giamatti and Mr Church all the way. Mr Payne's film has received five Oscar nominations. Nor is he alone in seizing on reality as a source for comedy.

In 1984 Bill Murray played Larry Darrell, the roaming idealist in “The Razor's Edge”. Steve Zissou, the Jacques Cousteau character in Wes Anderson's “The Life Aquatic” is his second shot at playing a world-weary seeker with a grizzled beard and a red Hemingway cap rallying his comrades, like Tennyson's Ulysses, to “sail beyond the sunset” one last time in the hope of redeeming some lost illusions.

Bloodthirsty pirates and high-tech competitors are only some of the problems that the ship encounters in its quest for the giant jaguar shark that Mr Murray swears ate his best friend, but these amount to little compared with the horde of phantoms—*Weltschmertz*, self-doubt, ennui and terminal irony—that are besieging Mr Murray at the moment. His ship, the *Belafonte*, which seems to run on marijuana, could have been christened the *Golden Sixties*, the age these baby-boomers are fast approaching and the source of their most cherished illusions. Mr Murray's nemesis, the jaguar shark, is an eight-foot puppet animated by Henry Selick in a clear nod towards Moby Dick, on whom they all dote.

His compatriot in satire, David O. Russell, also tackled generational themes in his 1996 film, “Flirting with Disaster”, where Ben Stiller went in search of his birth parents to find out whether he had the DNA of a Reaganite, a proletarian or an acid-head. Mr Russell's new comedy, “I Love Huckabees”, recounts how two existential detectives (Dustin Hoffman and Lily Tomlin) try to find meaning in the life of a depressed young activist (Jason Schwartzman). Along the way they meet a giant Sudanese refugee, an executive for a Walmart-style superstore, his poster-girl paramour

and a sombre fireman obsessed with America's dependency on oil. Strangely, it all makes some kind of sense by the end.

“Farce is more serious,” wrote Søren Kierkegaard, and Hollywood is proving him right with comedies such as these. They tackle many subjects that the industry has written off as a bad investment—and hand audiences a much-needed laugh in the process.

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Correction: Eritrea

Feb 17th 2005
From The Economist print edition

Two of the figures in the review of Michela Wrong's book about Eritrea ("Shadiness in the Sun" January 20th), were unfortunately conflated. An estimated 60,000 Eritreans died in the rebel war with Ethiopia which ended in 1991. A further 70,000 people are believed to have been killed in a 1998 border war, though this was on both sides of the conflict.

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About sponsorship

Obituary

Arthur Miller

Feb 17th 2005
From The Economist print edition

Arthur Miller, playwright, died on February 10th, aged 89

Magnum Photos

FOR most of his life, Arthur Miller was a carpenter. At 14, with the money made from delivering bagels on his bike round Harlem, he bought enough wood to build a back porch on the family house. In his old age, living on 360 acres in Connecticut, he made tables, chairs, a bed, a cabinet. To make extra-sure the angles were right, he once consulted a mathematician.

He loved making plays—which he did better than any other American of the 20th century, with the possible exception only of Tennessee Williams—for much the same reason. They gave him “an architectural pleasure”. He tried novels occasionally and wrote, in “Timebends” in 1987, a chaotic autobiography. But he revelled in the structure of the drama. He thought of Ibsen and Sophocles, his early influences, as master-carpenters, and of his own best plays as careful constructions of “hard actions, facts, the geometry of relationships”. It was no accident that his male characters were often skilful with their hands, even if they were good at little else.

Yet Mr Miller's plays were not conceived as simple artefacts. He meant them to move minds. If they could not do so, there was no point in writing them. His intention was to show the audience, in ordinary characters they might see every day, truths about themselves that they half-knew but would not acknowledge. Realising they were not alone in whatever they foolishly feared or unwisely hoped for, they might find the courage to change.

In “Death of a Salesman” (1949), the play that brought him global fame, he displayed in Willy Loman the futility of a salesman's life, the fragility of his dreams, his longing to leave a lasting mark on the world—and also, though Willy could not see it, the persistent strength of his family's love for him. In “A View from the Bridge” (1955) he anatomised, in Eddie Carbone, the unacknowledged terrors of incestuous passion. In several plays, the last written only a year before his death, he tried to unravel his own relationship with Marilyn Monroe, his wife for almost five years. She remained surrounded, however, by “a darkness that perplexed me”.

He also plunged into the past in order to illuminate the present. His account of the 17th-century Salem witch trials in “The Crucible” (1953) gave him the metaphor he needed to describe McCarthyism, a plague that touched him directly when he was called before the House UnAmerican Activities Committee in 1956 for attending meetings of communist writers. (He refused to name names, was held in contempt of Congress, fined, and had his passport withdrawn.) His play “Broken Glass” (1994), ostensibly about the 1930s, was intended as a

commentary on public indifference to the Yugoslav wars of the 1990s. His audiences did not always notice these parallels, but they were always meant to.

Fixing on a star

Throughout his work, his message was consistent. Actions had consequences, and the individual was responsible not only for his own acts, but for what he knew others were doing. In “All My Sons” (1947), his clearest statement of this philosophy, a father had secured the future of his family by shipping defective aircraft parts that had caused pilots to die; eventually, his own son reported him. There were moments, Mr Miller wrote, “when an individual conscience was all that could keep a world from falling.”

On the other hand, his characters were seldom that strong. Outside forces—destiny, law, political authority, sudden catastrophe—often overwhelmed them. As a child during the Depression, he had seen his father's coat-making business destroyed and his mother, whom he remembered in fox-fur and diamonds, reduced to eking out shovelfuls of coal. His father and his colleagues, he noticed, never blamed anyone but themselves for what had happened. Mr Miller, already imbued with his lifelong socialism, tried to persuade his shellshocked father to blame the capitalist system too, and accept that profit was wrong. His father, naturally, could not begin to understand him.

His career was not all adulation. He had a dry patch in the 1960s, when he felt he did not speak with the accent of the time, and by the 1980s the all-powerful New York critics (whom he loathed) seemed to be tired of him. Constantly, critics objected to his blatant stage moralising: “like neon signs”, one wrote, “in a diner window.”

Mr Miller was unapologetic. He had a purpose, he confessed, even beyond teaching. Though he seemed to be didactic, he was in fact asking questions: “How can we be useful?” “Why do we live?” He was, he once admitted, “in love with wonder...the wonder of how things and people got to be what they are.” The aim of each of his plays was to discover which commitment or challenge his main character would accept, and which he would walk away from: “that moment when out of a sky full of stars he fixes on one star.”

He remembered his own such moment, when he decided to be a writer. It came when, reading Dostoevsky's “The Brothers Karamazov” as a teenager, he discovered that among the most breathtaking passages were accumulations of hard, simple fact: “the kind of bark on the moonlit trees, the way a window is hinged”. As well as the playwright, it was the carpenter speaking.

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Overview

Feb 17th 2005
From The Economist print edition

Growth in the **euro zone** almost ground to a halt in the fourth quarter of 2004: GDP rose by only 0.2%, which left output 1.6% higher than a year earlier. GDP unexpectedly fell in the quarter in **Germany**, **Italy** and the **Netherlands**, but grew by a brisk 0.7% and 0.8% respectively in **France** and **Spain**.

However, forward-looking indicators suggest brighter times ahead, at least for **Germany**. The country's ZEW survey of growth expectations among economists and asset managers rose for a third month in February. The ZEW tends to precede changes in economic activity by around six months.

Japan's economy is technically back in recession. It's GDP fell by 0.1% in the fourth quarter, the third successive quarterly drop, leaving output 0.6% up on a year earlier. Third-quarter data were revised down, turning a 0.1% increase in output into a 0.3% decline. However, a breakdown of the numbers offers a less gloomy picture. Real GDP growth was depressed by an easing of deflation: the GDP deflator fell by only 0.3% in the year to the fourth quarter, compared with a fall of 1.8% in the second quarter. Indeed, prices actually rose in both the third and fourth quarters. On a calendar-year basis, real GDP rose by 2.6% in 2004 and nominal GDP rose by 1.4%—the first increase in four years.

America's industrial production was flat in January, which was weaker than expected, but it was still 4.0% higher than a year earlier. The value of retail sales dipped by 0.3% in January, as car sales fell sharply. Despite this, spending was 7.2% up on a year earlier.

In the three months to December, average wages in **Britain** were 4.3% higher than a year earlier, well above the 1.6% rise in consumer prices. In real terms, British wages are rising faster than in any other country in our table. In America, the euro area and Japan real wages have actually fallen over the past year. Britain's jobless rate held steady at 4.7% in the three months to December.

In 2004 **France** recorded its first trade deficit ($9.6 billion) for four years. This largely reflected the surge in the euro and higher oil prices. By contrast, Japan's trade and current-account surpluses both widened to record levels last year. The current-account surplus jumped to $172 billion from $136 billion in 2003.

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Output, demand and jobs

Feb 17th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.0	Q3	+ 1.2	+ 3.4	+ 3.1	+ 4.2	Q3	+ 2.2	Q4	5.1	Jan	5.7
Austria	+ 2.7	Q3	+ 3.2	+ 1.7	+ 2.1	+ 8.5	Nov	+ 7.0	Nov	4.5	Jan	4.5
Belgium	+ 2.9	Q3	+ 3.2	+ 2.6	+ 2.1	+ 3.0	Nov	+ 4.5	Nov	12.7	Jan†	12.9
Britain	+ 2.8	Q4	+ 3.0	+ 3.0	+ 2.4	+ 0.3	Dec	+ 3.2	Dec	4.7	Dec††	4.9
Canada	+ 3.3	Q3	+ 3.2	+ 2.7	+ 3.0	+ 3.8	Nov	+ 5.0	Oct	7.0	Jan	7.3
Denmark	+ 1.8	Q3	+ 0.5	+ 2.0	+ 2.0	+ 4.1	Dec	+ 9.8	Dec	6.2	Dec	6.7
France	+ 2.1	Q4	+ 2.8	+ 2.1	+ 1.9	+ 2.0	Dec	+ 2.8	Dec	9.9	Dec	9.9
Germany	+ 1.5	Q4‡‡	– 0.9	+ 1.2	+ 1.3	+ 0.9	Dec	– 5.9	Dec	11.4	Jan§	10.2
Italy	+ 1.0	Q4	– 1.2	+ 1.3	+ 1.4	– 3.2	Dec	– 2.1	Nov	7.7	Jun	8.6
Japan	+ 0.6	Q4	– 0.5	+ 3.0	+ 1.6	+ 1.8	Dec	– 1.0	Dec	4.4	Dec	4.9
Netherlands	+ 1.3	Q4	– 0.3	+ 1.3	+ 1.3	+ 0.1	Dec	– 0.6	Nov‡	6.5	Jan**	6.1
Spain	+ 2.7	Q4	+ 3.2	+ 2.4	+ 2.4	+ 1.3	Dec	+ 2.5	Dec	10.4	Dec	11.2
Sweden	+ 3.9	Q3	+ 3.8	+ 3.4	+ 2.9	– 3.7	Dec	+ 4.8	Dec	5.3	Dec†	5.1
Switzerland	+ 1.8	Q3	+ 1.4	+ 1.7	+ 1.7	+ 3.5	Q3	– 0.5	Dec	4.1	Jan†	4.3
United States	+ 3.7	Q4	+ 3.1	+ 4.3	+ 3.5	+ 4.0	Jan	+ 5.9	Dec	5.2	Jan	5.7
Euro area	+ 1.6	Q4	+ 0.8	+ 1.8	+ 1.6	+ 0.5	Nov	+ 0.5	Dec	8.9	Dec	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 3.2	Q3	+ 4.3	na	na	+12.0	Dec	+ 4.0	Nov	7.7	Dec†	8.2
Greece	+ 4.0	Q4	nil	na	na	– 0.9	Dec	+ 2.8	Nov	10.7	Mar	9.8
Iceland	+ 7.4	Q3	na	na	na	na		na		2.7	Dec†	3.4
Ireland	+ 5.8	Q3	na	na	na	+ 0.3	Dec	+ 4.2	Nov	4.2	Jan	4.4
Luxembourg	+ 2.12003		na	na	na	+ 2.4	Nov	+ 5.4	Nov	4.5	Dec	4.2
New Zealand	+ 4.0	Q3	+ 1.9	na	na	+ 4.5	Q3	+ 7.4	Q3	3.8	Q3	4.4
Norway	+ 1.8	Q3	– 3.9	na	na	– 0.5	Dec	+ 2.4	Dec	4.1	Jan‡	4.3
Portugal	+ 0.8	Q3	– 4.9	na	na	– 2.1	Dec	+ 5.2	Dec	6.8	Q3†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Oct-Dec; claimant count rate 2.6% in Jan. §EU harmonised rate 10.0% in Dec. **Nov-Jan. ‡‡Working day-adjusted

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Prices and wages

Feb 17th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.6	Q4	+ 2.4	+ 2.3	+ 2.4	+ 8.2	Q4	– 1.1	+ 3.7	Q3	+ 5.1
Austria	+ 2.9	Dec	+ 1.2	+ 2.0	+ 1.7	+ 4.7	Jan	+ 2.2	+ 2.0	Dec	+ 2.3
Belgium	+ 2.3	Jan	+ 1.6	+ 2.0	+ 1.8	+ 5.3	Dec	– 0.4	+ 2.4	Oct	+ 1.8
Britain	+ 1.6	Jan*	+ 1.4	+ 1.5	+ 1.7	+ 2.6	Jan	+ 1.6	+ 4.3	Dec†	+ 3.4
Canada	+ 2.1	Dec	+ 2.0	+ 1.9	+ 2.0	+ 3.8	Dec	– 3.5	+ 2.3	Oct	+ 3.2
Denmark	+ 1.0	Jan	+ 1.1	+ 1.1	+ 1.6	+ 3.0	Jan	+ 0.3	+ 2.9	Q3	+ 3.7
France	+ 2.1	Dec	+ 2.2	+ 2.2	+ 1.6	+ 3.0	Dec	+ 0.3	+ 2.7	Q3	+ 2.9
Germany	+ 1.6	Jan	+ 1.2	+ 1.7	+ 1.3	+ 3.4	Jan	+ 0.4	+ 0.3	Nov	+ 0.6
Italy	+ 1.9	Jan	+ 2.2	+ 2.2	+ 2.0	+ 4.2	Dec	+ 0.8	+ 3.3	Dec	+ 2.7
Japan	+ 0.2	Dec	– 0.4	nil	+ 0.3	+ 1.3	Jan	nil	– 0.5	Dec	+ 3.0
Netherlands	+ 1.5	Jan	+ 1.3	+ 1.3	+ 1.2	+ 5.2	Dec	– 0.3	+ 0.7	Jan	+ 1.7
Spain	+ 3.1	Jan	+ 2.3	+ 2.8	+ 2.7	+ 5.0	Dec	+ 1.1	+ 2.2	Q3	+ 3.1
Sweden	+ 0.4	Dec	+ 1.4	+ 0.6	+ 1.3	+ 2.0	Dec	– 1.9	+ 2.4	Nov	+ 3.4
Switzerland	+ 1.2	Jan	+ 0.2	+ 0.9	+ 1.1	+ 1.3	Jan	– 0.2	+ 1.4	2003	+ 1.8
United States	+ 3.3	Dec	+ 1.9	+ 2.7	+ 2.4	+ 4.3	Dec	+ 4.3	+ 2.6	Jan	+ 2.0
Euro area	+ 2.1	Jan	+ 1.9	+ 2.1	+ 1.7	+ 3.6	Dec	+ 1.0	+ 2.0	Q3	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.2	Jan	+ 0.2	na	na	+ 1.2	Jan	– 0.7	+ 3.1	Q3	+ 4.3
Greece	+ 4.0	Jan	+ 2.9	na	na	+ 2.9	Dec	+ 2.1	na		na
Iceland	+ 4.5	Feb	+ 2.3	na	na	+ 8.6	Jan	+ 1.3	+ 6.0	Dec	+ 5.4
Ireland	+ 2.3	Jan	+ 1.8	na	na	– 1.6	Dec	– 9.1	+ 4.5	Q3	+ 4.6
Luxembourg	+ 2.0	Jan	+ 2.1	na	na	+17.0	Dec	+ 0.1	+ 2.5	Nov	na
New Zealand	+ 2.7	Q4	+ 1.6	na	na	+ 2.5	Q3	+ 0.1	+ 2.5	Q4	+ 2.3
Norway	+ 1.1	Jan	– 1.8	na	na	+11.7	Jan	– 0.1	+ 4.6	Q3	+ 4.2
Portugal	+ 2.0	Jan	+ 2.3	na	na	+ 4.7	Dec	nil	– 0.6	Dec	– 2.9

*New series. RPI inflation rate 3.2% in Jan. †Oct-Dec.

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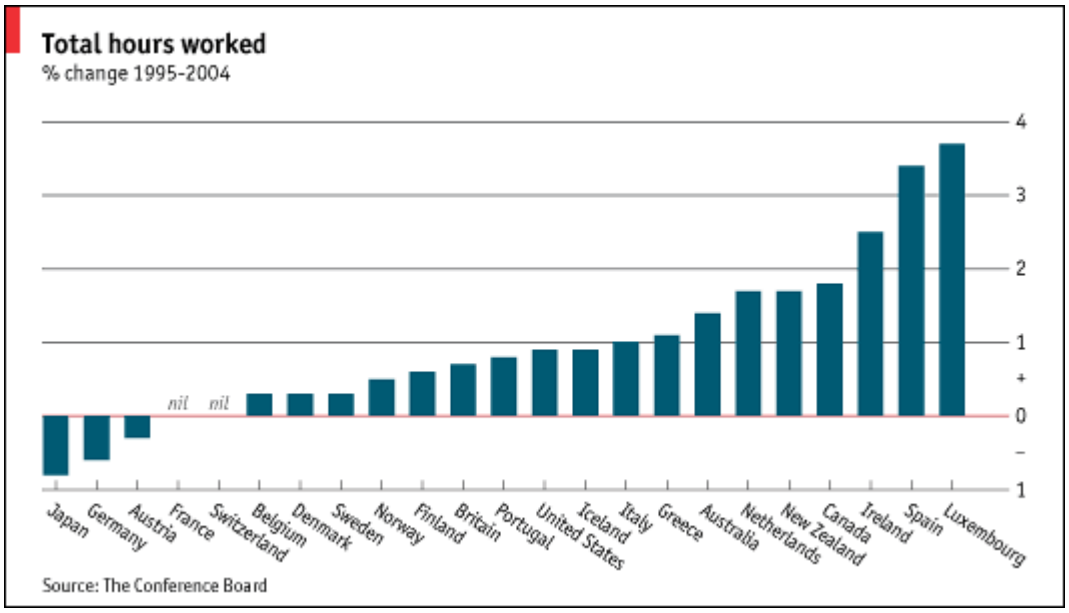
Total hours worked

Feb 17th 2005
From The Economist print edition



Improving productivity is a common goal of economic policy, but increasing the number of hours worked will also raise incomes. Of the countries in our chart, Luxembourg and Spain have seen the biggest increases in the total number of hours worked since 1995, by more than 3%, compared with a modest rise of 0.9% in America. In Germany and Japan hours worked fell during that period, as average GDP growth slowed sharply.

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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Feb 16th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 2.6	+ 9.2	Dec	5.67	5.55	5.43	5.40	5.55	6.31
Britain	+ 5.8	+ 8.6	Dec	4.84	4.09	4.59	4.58	4.79	5.24
Canada	+11.2	+10.4	Dec	2.43	2.19	2.92	4.26	4.45	5.65
Denmark	+14.4	+12.7	Dec	2.20	2.18	2.43	3.57	4.19	4.98
Japan	+ 4.2	+ 2.0	Jan	0.02	0.03	0.12	1.42	1.23	1.53
Sweden	– 0.2	+ 4.6	Dec	1.95	2.42	2.13	3.65	4.40	2.16
Switzerland	– 5.3	+ 1.2	Dec	0.75	0.26	0.94	2.06	2.38	2.11
United States	+ 4.9	+ 5.9	Jan	2.60	1.01	3.42	4.16	4.03	5.26
Euro area†	+ 8.4	+ 6.4	Dec	2.14	2.06	2.40	3.50	4.03	3.67

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.52%, Japan No. 267 1.42%. Central bank rates: US fed funds 2.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 17th 2005
From The Economist print edition

2000=100

	Feb 8th	Feb 15th*	% change on one month	% change on one year
Dollar index				
All items	125.8	128.6	+ 3.2	– 4.1
Food	118.0	121.1	+ 2.8	– 8.7
Industrials				
All	135.9	138.4	+ 3.7	+ 1.6
Nfa†	127.5	127.1	+ 4.0	–11.7
Metals	140.5	144.6	+ 3.6	+ 9.6
Sterling index				
All items	102.8	103.4	+ 2.1	– 3.4
Euro index				
All items	91.1	91.7	+ 3.7	– 5.2
Yen index				
All items	123.5	124.9	+ 5.3	– 5.2
Gold				
$ per oz	412.30	425.13	+ 0.5	+ 2.8
West Texas Intermediate				
$ per barrel	45.42	47.26	– 2.2	+34.4

* Provisional. † Non-food agriculturals.

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Stockmarkets

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From The Economist print edition

Market indices

	Feb 16th	2004-05 high	2004-05 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	4,142.8	4,182.9	3,274.9	– 0.5	– 1.0	+25.3	+30.0
Austria (ATX)	2,636.9	2,636.9	1,568.9	+ 2.2	nil	+70.7	+75.7
Belgium (Bel 20)	3,121.6	3,128.9	2,244.2	+ 1.2	–15.2	+39.1	+43.2
Britain (FTSE 100)	5,053.2	5,058.9	4,287.0	+ 1.3	–27.1	+12.9	+18.5
Canada (Toronto Composite)	9,639.6	9,639.6	8,123.5	+ 2.5	–15.4	+17.3	+21.9
Denmark (KBX)	275.7	277.0	219.0	+ 1.5	– 8.6	+29.1	+32.9
France (SBF 250)	2,781.3	2,795.0	2,386.1	+ 1.0	–36.7	+15.3	+18.7
(CAC 40)	4,009.0	4,030.5	3,465.3	+ 1.0	–42.1	+12.7	+16.0
Germany (DAX)	4,368.8	4,402.0	3,647.0	+ 0.4	–45.8	+10.2	+13.4
Italy (BCI)	1,550.4	1,559.3	1,239.5	nil	–29.0	+23.4	+27.0
Japan (Nikkei 225)	11,601.7	12,163.9	10,365.4	+ 1.1	–70.2	+ 8.7	+10.4
(Topix)	1,164.9	1,217.9	1,022.6	+ 0.8	–59.6	+11.6	+13.4
Netherlands (AEX)	372.5	373.8	310.7	+ 1.1	–46.9	+10.3	+13.6
Spain (Madrid SE)	1,020.7	1,025.8	804.4	+ 1.3	–10.9	+26.3	+30.1
Sweden (Affarsvarlden Gen)	230.4	231.9	188.5	– 0.4	–42.5	+22.3	+25.8
Switzerland (Swiss Market)	5,870.8	5,934.4	5,309.7	+ 0.1	–30.2	+ 7.0	+11.0
United States (DJIA)	10,834.9	10,854.5	9,750.0	+ 1.6	– 7.6	+ 3.6	+ 3.6
(S&P 500)	1,210.3	1,213.6	1,063.2	+ 1.5	–20.8	+ 8.9	+ 8.9
(NASDAQ Comp)	2,087.4	2,178.3	1,752.5	+ 1.7	–58.7	+ 4.2	+ 4.2
Europe (FTSEurofirst 300)*	1,096.6	1,103.2	940.9	+ 0.8	–35.7	+14.5	+17.9
Euro area (FTSE Euro 100)*	939.1	944.6	787.2	+ 0.8	–39.4	+12.9	+16.2
World (MSCI)†	1,169.6	1,172.3	997.0	+ 1.8	–19.3	+12.9	+12.9
World bond market (Citigroup)‡	651.9	666.7	575.1	+ 0.3	– 2.2	+ 8.0	+ 8.0

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 17th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Feb 16th	year ago	Currency units per $ Feb 16th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 18.0	Dec	− 36.2	Q3	− 6.0	− 5.4	89.0	91.0	1.28	1.26	2.40	1.66	1.21	+ 0.7
Austria	+ 0.5	Nov	− 1.8	Nov	− 0.6	− 0.7	106.1§	105.1	0.77	0.78	1.45	–	0.73	− 1.5
Belgium	+ 20.9	Dec	+ 11.7	Sep	+ 3.7	+ 3.5	106.7§	105.4	0.77	0.78	1.45	–	0.73	− 0.1
Britain	−105.5	Dec	− 47.4	Q3	− 2.3	− 2.6	103.0	105.7	0.53	0.52	–	0.69	0.50	− 3.2
Canada	+ 51.6	Dec	+ 26.7	Q3	+ 2.7	+ 2.1	92.0	87.2	1.24	1.31	2.33	1.61	1.18	+ 1.1
Denmark	+ 9.8	Dec	+ 5.8	Dec	+ 2.9	+ 2.8	107.1	107.1	5.73	5.81	10.8	7.44	5.44	+ 0.9
France	− 9.6	Dec	− 6.3	Dec	nil	+ 0.1	110.6§	109.1	0.77	0.78	1.45	–	0.73	− 3.7
Germany	+194.2	Dec	+ 96.0	Dec	+ 3.0	+ 3.0	108.5§	106.7	0.77	0.78	1.45	–	0.73	− 3.9
Italy	+ 0.3	Nov	− 12.0	Nov	− 0.9	− 1.0	78.6§	77.5	0.77	0.78	1.45	–	0.73	− 2.9
Japan	+132.3	Dec	+171.8	Dec	+ 3.6	+ 3.5	135.8	135.6	105	106	198	137	–	− 6.5
Netherlands	+ 37.0	Dec	+ 24.1	Q4	+ 3.0	+ 3.1	106.2§	104.9	0.77	0.78	1.45	–	0.73	− 2.9
Spain	− 72.5	Nov	− 44.5	Nov	− 3.1	− 3.4	78.6§	77.9	0.77	0.78	1.45	–	0.73	− 1.1
Sweden	+ 22.9	Dec	+ 26.2	Q3	+ 6.4	+ 5.7	82.7	81.7	6.99	7.16	13.1	9.08	6.63	+ 0.5
Switzerland	+ 8.0	Dec	+ 44.7	Q3	+12.5	+12.1	113.1	110.7	1.19	1.23	2.24	1.55	1.13	− 1.6
United States	−666.2	Dec	−603.2	Q3	− 5.6	− 5.9	91.8	93.6	–	–	1.88	1.30	0.95	− 4.4
Euro area	+ 93.9	Nov	+ 48.3	Nov	+ 0.5	+ 0.6	93.0	92.4	0.77	0.78	1.45	–	0.73	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.9	Dec	+ 8.6	Dec	na	na	84.3§	83.2	0.77	0.78	1.45	–	0.73	+ 2.3
Greece	− 31.2	Nov	− 10.0	Nov	na	na	60.7§	60.5	0.77	0.78	1.45	–	0.73	− 5.3
Iceland	− 0.8	Nov	− 0.6	Q3	na	na	96.6**	93.2	62.3	67.6	117	80.9	59.1	+ 0.1
Ireland	+ 41.8	Nov	− 1.6	Q3	na	na	99.9§	97.8	0.77	0.78	1.45	–	0.73	+ 0.2
Luxembourg	− 4.4	Nov	+ 2.3	Q3	na	na	106.7§	105.4	0.77	0.78	1.45	–	0.73	− 0.4
New Zealand	− 2.8	Dec	− 5.3	Q3	na	na	108.8	108.0	1.40	1.43	2.63	1.82	1.33	+ 2.9
Norway	+ 34.5	Jan	+ 33.8	Nov	na	na	97.0	91.8	6.44	6.87	12.1	8.36	6.11	+ 8.2
Portugal	− 18.5	Nov	− 12.6	Nov	na	na	94.0**	93.4	0.77	0.78	1.45	–	0.73	− 2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate. ††New series.
**IMF, October average.

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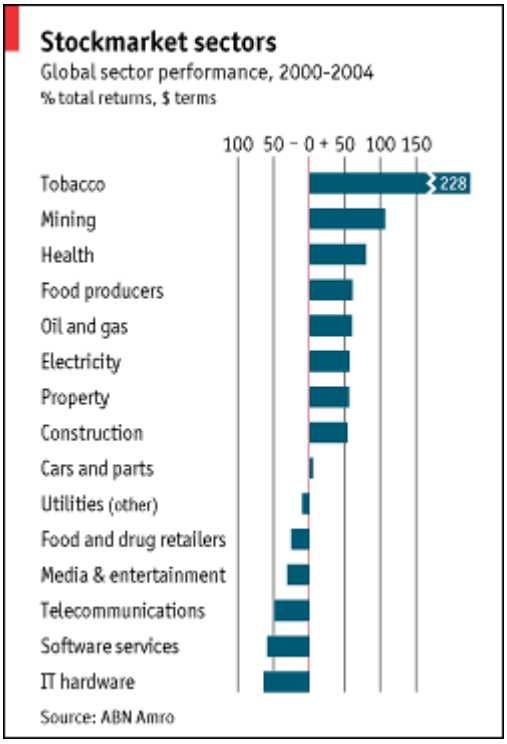
Stockmarket sectors

Feb 17th 2005
From The Economist print edition



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Overview

Feb 17th 2005
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Indonesia grew by 6.7% in the year to the fourth quarter. In **India**, industrial production rose by 7.9% in the 12 months to December. In the **Philippines**, consumer prices increased by 8.4% in the year to January.

Mexico grew by 4.9% in the year to the fourth quarter. **Venezuela** expanded by 11.2% over the same period. And **Peru's** GDP rose by 9.1% in the year to December.

Industrial production in **Brazil** increased by 8.3% in the 12 months to December. In **Chile**, it expanded by 10.2% over the same period.

South Africa grew by 4.7% in the year to the fourth quarter.

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The Economist poll of forecasters

Feb 17th 2005
From The Economist print edition

Every three months, *The Economist* polls a group of forecasters and averages their predictions for growth and current-account balances in 25 emerging economies. Compared with November, our seers have raised their projections for 2005 GDP growth in 13 countries and lowered them in ten. In particular, they have become more optimistic about Latin America. In November they expected that Argentina's GDP growth would slow from over 7% in 2004 to 4.2% in 2005. Their latest forecast predicts Argentina will grow by 5.3% this year.

The Economist poll of forecasters

February

	Real GDP % change		Current account % of GDP	
	2004	2005	2004	2005
China	9.5	8.3	2.8	2.3
Hong Kong	7.9	4.7	8.1	7.9
India	6.7	6.6	nil	–0.1
Indonesia	4.8	4.6	1.3	0.8
Malaysia	7.1	5.0	13.3	11.4
Philippines	6.0	4.5	3.8	3.0
Singapore	8.2	4.2	27.3	25.2
South Korea	4.6	3.6	4.1	3.2
Taiwan	5.9	4.2	6.6	5.7
Thailand	6.1	5.0	3.7	2.7
Argentina	7.9	5.3	3.2	1.9
Brazil	5.1	3.7	1.7	0.5
Chile	5.7	5.5	2.2	0.8
Colombia	3.7	3.6	–1.3	–1.8
Mexico	4.2	3.9	–1.6	–1.7
Peru	4.6	4.2	–0.5	–0.6
Venezuela	16.2	4.9	13.6	10.1
Egypt	3.9	4.3	4.5	2.9
Israel	4.1	3.5	–0.1	–0.6
South Africa	3.6	3.9	–2.7	–3.0
Czech Republic	3.7	3.9	–5.8	–5.5
Hungary	3.9	3.5	–9.0	–8.7
Poland	5.6	4.6	–1.5	–1.8
Russia	6.8	5.7	9.7	7.1
Turkey	8.1	5.0	–4.9	–4.3

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; J.P.Morgan Chase; Merrill Lynch; Citigroup; UBS Warburg.

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Economy

Feb 17th 2005
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q4	+14.4	Dec	+ 2.4	Dec	+38.4	Jan	+45.9	2003	609.9	Dec
Hong Kong	+ 7.2	Q3	+ 3.4	Q3	+ 0.2	Dec	−12.1	Dec	+14.2	Q3	124.7	Jan
India	+ 6.6	Q3	+ 7.9	Dec	+ 3.8	Dec	−23.6	Jan	+ 3.5	Q3	123.7	Jan
Indonesia	+ 6.7	Q4	− 2.3	Aug	+ 7.3	Jan	+24.1	Dec	+ 4.0	Q3	35.0	Dec
Malaysia	+ 6.8	Q3	+ 5.8	Dec	+ 2.4	Jan	+21.3	Dec	+14.7	Q3	65.9	Dec
Philippines	+ 5.4	Q4	+ 8.7	Nov	+ 8.4	Jan†	− 0.8	Nov	+ 4.4	Sep	12.9	Jan
Singapore	+ 6.5	Q4	+31.7	Dec	+ 1.5	Dec	+15.4	Jan	+29.0	Q3	112.0	Jan
South Korea	+ 4.6	Q3	+ 4.5	Dec	+ 3.1	Jan	+30.2	Jan	+27.6	Dec	199.6	Jan
Taiwan	+ 5.3	Q3	− 0.9	Dec	+ 0.5	Jan	+ 4.7	Jan	+24.8	Q3	242.7	Jan
Thailand	+ 6.0	Q3	+ 3.0	Dec	+ 2.7	Jan	+ 1.7	Dec	+ 7.3	Dec	48.7	Dec
Argentina	+ 8.3	Q3	+ 5.4	Nov	+ 7.2	Jan	+12.1	Dec	+ 3.6	Q3	20.1	Jan
Brazil	+ 6.1	Q3	+ 8.3	Dec	+ 7.4	Jan	+34.3	Jan	+11.7	Dec	52.9	Dec
Chile	+ 6.8	Q3	+10.2	Dec	+ 2.2	Jan	+ 9.4	Jan	+ 2.0	Q3	15.6	Jan
Colombia	+ 2.4	Q3	+ 5.6	Nov	+ 5.4	Jan	+ 0.9	Oct	− 1.4	Q3	13.6	Jan
Mexico	+ 4.9	Q4	+ 3.9	Dec	+ 4.5	Jan	− 8.1	Dec	− 5.5	Q3	64.1	Dec
Peru	+ 9.1	Dec	+10.8	Nov	+ 3.0	Jan	+ 2.7	Dec	− 0.3	Q3	12.3	Jan
Venezuela	+11.2	Q4	+23.1	Nov	+18.5	Jan	+21.5	Q3	+14.6	Q4	18.2	Oct
Egypt	+ 4.7	Q4	+ 3.3	2004‡	+11.4	Dec	− 8.1	Q3	+ 4.1	Q3	13.8	Nov
Israel	+ 2.9	Q3	+13.7	Nov	+ 0.8	Jan	− 7.1	Jan	+ 0.5	Q3	27.1	Jan
South Africa	+ 4.7	Q4	+ 7.8	Dec	+ 3.4	Dec	− 1.9	Dec	− 4.7	Q3	13.4	Jan
Czech Republic	+ 3.6	Q3	+ 8.3	Dec	+ 1.7	Jan	− 0.8	Dec	− 6.4	Q3	27.8	Jan
Hungary	+ 3.7	Q3	− 1.4	Dec	+ 4.1	Jan	− 2.5	Q3	− 8.6	Q3	15.0	Jan
Poland	+ 4.8	Q3	+ 6.4	Dec	+ 4.0	Jan	− 6.1	Nov	− 3.0	Dec	35.3	Dec
Russia	+ 6.4	Q3	+ 4.8	Dec	+12.7	Jan	+87.0	Dec	+49.5	Q3	121.2	Jan
Turkey	+ 4.5	Q3	+ 4.7	Dec	+ 9.2	Jan	−34.5	Dec	−15.6	Dec	36.0	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.1	Q3	+ 5.0	Dec	+ 4.2	Jan	− 2.7	Nov	− 1.5	Q3	1.6	Nov
Latvia	+ 9.1	Q3	+ 6.0	Nov	+ 6.6	Jan	− 2.7	Nov	− 1.7	Nov	1.8	Nov
Lithuania	+ 6.4	Q4	na		+ 2.9	Jan	− 3.2	Nov	− 2.0	Q3	3.6	Nov
Slovakia	+ 5.3	Q3	+ 0.4	Dec	+ 3.2	Jan	− 1.4	Dec	− 0.9	Sep	13.4	Nov
Slovenia	+ 4.9	Q3	+ 6.3	Dec	+ 2.2	Jan	− 1.3	Dec	− 0.1	Dec	8.2	Oct
Pakistan	+ 6.4	2004‡	+12.1	Sep	+ 8.5	Jan	− 5.0	Dec	− 0.9	Q4	9.8	Dec
Saudi Arabia	+ 7.2	2003	na		+ 0.6	Nov	+59.1	2003	+28.0	2003	27.3	Dec

*Excluding gold, except Singapore; IMF definition. †New series ‡Year ending June, new series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Financial markets

Feb 17th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 16th		Dec 31st 2003	
	Feb 16th	year ago	Feb 16th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.5	3.30	1,343.0	+0.8	– 14.4	– 14.4
Hong Kong	7.80	7.77	14.7	1.40	14,015.5**	+1.2	+ 11.4	+ 10.9
India	43.7	45.2	82.2	5.23	6,607.8	+0.2	+ 13.2	+ 18.1
Indonesia	9,295	8,415	17,462	7.56	1,073.4	+3.6	+ 55.1	+ 40.6
Malaysia	3.80	3.80	7.14	2.82	919.4	+0.5	+ 15.8	+ 15.8
Philippines	55.1	55.9	103.5	6.31	2,078.5	+2.4	+ 44.1	+ 45.3
Singapore	1.64	1.67	3.09	1.81	2,155.1	+0.7	+ 22.1	+ 26.2
South Korea	1,026	1,161	1,927	3.60	971.6	+2.4	+ 19.8	+ 39.2
Taiwan	31.6	33.1	59.3	1.35	6,143.5	+1.8	+ 4.3	+ 12.1
Thailand	38.6	38.9	72.5	2.50	739.4	+0.5	– 4.2	– 1.7
Argentina	2.90	2.94	5.45	4.44	1,508.8	+1.6	+ 40.8	+ 42.3
Brazil	2.60	2.92	4.88	18.26	26,384.0	+0.3	+ 18.7	+ 31.8
Chile	570	583	1,070	2.88	8,941.4	+0.2	+ 21.9	+ 26.7
Colombia	2,332	2,736	4,381	7.38	4,852.0	+2.0	+107.9	+147.8
Mexico	11.2	11.0	21.0	9.15	13,640.8	–0.2	+ 55.1	+ 56.0
Peru	3.26	3.49	6.12	2.88	3,937.6	+3.1	+ 61.7	+ 71.9
Venezuela	2,718§	2,988§	5,106	10.73	30,051.5	+1.2	+ 35.3	+ 42.0
Egypt	5.82	6.18	10.93	9.90	32,064.7	+4.3	+175.5	+191.9
Israel	4.37	4.48	8.21	1.00	670.5	+0.9	+ 25.5	+ 26.2
South Africa	6.00	6.87	11.3	7.60	13,181.1	+0.6	+ 26.9	+ 41.2
Czech Republic	23.2	25.7	43.5	2.23	1,148.6	+2.5	+ 74.3	+ 93.3
Hungary	188	207	353	8.49	17,360.4	+5.4	+ 85.1	+104.4
Poland	3.08	3.82	5.78	6.51	27,500.7	+2.9	+ 32.1	+ 60.6
Russia	28.0	28.5	52.6	13.00	662.0‡	+0.9	+ 11.3	+ 15.7
Turkey	1.35	1.33	2.53	18.37	27,661.6	–1.5	+ 47.8	+ 54.5
EMF (MSCI)*	1.00	1.00	1.88	na	562.5	+1.9	+ 27.0	+ 27.0
EMBI+†	1.00	1.00	1.88	na	335.6	–0.5	+ 13.8	+ 13.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **Feb 8th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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